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# CALL IT A COMEBACK: A SWEEPING CHANGE IN THE LAW ON DECLARATORY JUDGMENT ACTIONS AGAINST PATENT OWNERS

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## INTRODUCTION

Since the beginning of the 2006 Term, the Supreme Court has altered several fundamental patent law doctrines. In the eyes of some, these Supreme Court decisions reflect the view that excessive patent protection fails to promote, and instead impedes, technological development and innovation.<sup>1</sup> Under such a view, technological development and innovation can be unencumbered by shifting power away from patent owners and toward those who would challenge patents, improving the quality of patents by lowering the bar for challenging the validity and enforceability of patents in court.

Whether or not this view accurately reflects the ideology behind the Supreme Court's recent rulings, it is apparent that the

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1. See, e.g., Stephen J. Rizzi, *Courts, Not Congress, Shaped Patent Law in 2007*, IP LAW360, Jan. 3, 2008, <http://ip.law360.com/Secure/ViewArticle.aspx?id=43056> ("The Supreme Court's rulings restricted the extraterritorial reach of U.S. patent law, loosened the standard for district courts' declaratory judgment jurisdiction over patent disputes, and perhaps most importantly, liberalized the test for invalidity based on 'obviousness,' thereby increasing infringement defendants' chances of prevailing on this issue."); S. Jay Plager, *A Review of Recent Decisions of the United States Court of Appeals for the Federal Circuit—Foreword: The Price of Popularity: The Court of Appeals for the Federal Circuit 2007*, 56 AM. U. L. REV. 751, 755–58 (2007) (describing the Supreme Court's tendency to disfavor special rules for patent cases and efforts to bring the Court of Appeals for the Federal Circuit's law into line with mainstream doctrine); Christopher A. Harkins, *Fending Off Paper Patents and Patent Trolls: A Novel "Cold Fusion" Defense Because Changing Times Demand It*, 17 ALB. L.J. SCI. & TECH. 407, 427–29 (2007) (discussing several Justices' opinions that "sometimes too much patent protection can impede . . . the constitutional objective of patent and copyright protection" (internal citation omitted) (emphasis omitted)).

Court has made significant efforts to realign the patent laws with other non-patent law jurisprudence.<sup>2</sup> In so doing, the Court has tipped the balance of power away from patent owners and toward patent challengers—for example, by rejecting patent jurisprudential constraints on actions that seek declaratory judgments of patent invalidity or non-infringement, or on common-law claims.<sup>3</sup> These changes are likely to have significant consequences for businesses that deal with patented technology, especially with regard to how patent owners and licensees or potential licensees communicate and negotiate with each other.

One of the Court's decisions from last year, *MedImmune, Inc. v. Genentech, Inc.*,<sup>4</sup> significantly altered the relationship between the parties to patent license agreements. The Court held that the "case or controversy" requirement of the U.S. Constitution<sup>5</sup> does not require a licensee to terminate or breach a license agreement before seeking a declaratory judgment that the licensed patents are invalid or not infringed.<sup>6</sup> The *MedImmune* decision illustrates the sweeping change in the law that has weakened the rights of patent owners to enforce their patents and strengthened the rights of patent licensees to challenge those patents. *MedImmune* and the cases in its orbit have significantly altered the playing field for parties to patent licenses and patent litigations.

Part I of this Article introduces the reader to basic background norms of patent law and describes general parameters of and issues presented by the patent licensing process. Part II provides an explanation of the development of jurisprudence concerning license-related patent challenges, paying particular attention to the recent shift in the balance of power toward the current or prospective licensee and away from the current or prospective licensor. Part II also attempts to identify future developments in patent licensing

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2. See, e.g., *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764, 774 n.11, 777 (2007) (rejecting the "reasonable apprehension of suit" test used in patent cases for determining whether a patent case in which declaratory judgment is sought satisfies the case-or-controversy requirement of Article III of the U.S. Constitution); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391–94 (2006) (rejecting a "general rule" in patent cases that courts will issue permanent injunctions against patent infringement absent exceptional circumstances and holding that traditional principles in equity and the four-factor test that governs permanent injunctions in other cases should also govern permanent injunctions in patent cases).

3. Common-law claims used to challenge patents include unfair competition and breach of contract or license.

4. 127 S. Ct. 764 (2007).

5. U.S. CONST. art. III, § 2.

6. *MedImmune*, 127 S. Ct. at 777.

behavior and their legal ramifications. Part III voices concerns about the future well-being of patent owners in the new world of heavy licensee protection and makes predictions about litigation volume and industry practices.

## I. BACKGROUND DISCUSSION OF PATENT LAW

### A. *The Importance of Patents*

A patent grants its owner the right to exclude others from making, using, or selling the patented invention during the limited term of the patent.<sup>7</sup> During this period of exclusivity, a patent owner can legally prohibit others from using the patented invention without the owner's authorization by enforcing the patent rights to enjoin infringing activity and/or, at the least, to recover damages.<sup>8</sup> Alternatively, the patent owner can authorize others to use the patented invention in exchange for compensation, such as royalties pursuant to a patent license agreement.

Patents are valuable to society because they foster public disclosure of technological development and innovation by granting inventors limited exclusive rights for their patented inventions.<sup>9</sup> Many court decisions have referred to this bargain as a *quid pro quo*.<sup>10</sup> In exchange for the limited period of exclusivity, the inventor must make a full public "disclosure of how to make and use the invention, as well as the best mode of carrying it out."<sup>11</sup>

Patents are valuable to individuals or companies who own them because they can provide effective economic benefits, despite being very costly to obtain. For a patent owner, a patent is perhaps

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7. 35 U.S.C. § 271 (defining patent infringement as making, using, offering to sell, or selling any patented invention during the relevant patent term and identifying examples of both infringing and non-infringing behavior).

8. *See, e.g.*, 35 U.S.C. §§ 284, 271(e)(4) (describing injunctive relief and damages available to patent owners under federal law).

9. *See* HERBERT F. SCHWARTZ, *PATENT LAW AND PRACTICE* 3 (5th ed. 2006); Edmund W. Kitch, *The Nature and Function of the Patent System*, 20 J.L. & ECON. 265, 278-79 (1977); *see also, e.g.*, *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 10-11 (1966) ("The difficulty of formulating conditions for patentability was heightened by the generality of the constitutional grant and the statutes implementing it, together with the underlying policy of the patent system that 'the things which are worth to the public the embarrassment of an exclusive patent,' as Jefferson put it, must outweigh the restrictive effect of the limited patent monopoly.").

10. *E.g.*, *LizardTech, Inc. v. Earth Resource Mapping, Inc.*, 433 F.3d 1373, 1375 (Fed. Cir. 2006).

11. *Id.*

best viewed as an intangible asset that can be leveraged to recoup the costs of developing the patented invention, while also creating incentives to invest in future technological development and innovation. Applying for and securing patent protection can require substantial resources.<sup>12</sup> Thus, companies must manage their patent portfolios effectively to maintain competitive advantages in the global marketplace. Companies must make decisions about the areas of research and development in which to invest and pursue patent rights, as well as about which patents to enforce. The key to maximizing investment return on a patent is to concentrate on securing meaningful protection for the portion or component of the invention that provides a competitive advantage. Because a patent grants a right of exclusion, rather than the affirmative right to make, use, or sell the patented invention,<sup>13</sup> an enterprising inventor should focus on what to exclude its competitors from doing. This approach, if successful, enables the patent owner to garner a foothold in an industry, to gain economic benefit from its inventions, and to fund future improvements.

### *B. The Importance of Patent Licensing*

The degree to which companies can capitalize on the value of their own patented technology depends on the extent to which they can protect and exploit their own patents, as well as the extent to which the companies can gain access to essential patents held by others. Patent license agreements lie at the heart of both endeavors.

A common misconception about patents is that they grant patent owners the affirmative right to make, use, or sell the patented inventions. As noted above, however, the right granted by patents is the right to exclude others from exploiting the patented inventions.<sup>14</sup> Accordingly, it is possible, and is often the case, that a patent owner cannot make, use, or sell a patented invention without obtaining rights from other patent owners whose patents cover other aspects of the patented invention. Many patented inventions

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12. Gene Quinn, *Cost of Obtaining a Patent*, IPWatchdog, <http://www.ipwatchdog.com/patent/patent-cost/>.

13. The negative right to exclude others from practicing a patented invention is codified as 35 U.S.C. § 271(a). There is no affirmative right to practice one's own patented invention. *See, e.g.,* *Biotech. Indus. Org. v. District of Columbia*, 505 F.3d 1343, 1346 (Fed. Cir. 2007) ("It is, of course, well established that the patent laws . . . do not 'create any affirmative right to make, use, or sell anything.'" (quoting *Leatherman Tool Group v. Cooper Indus.*, 131 F.3d 1011, 1015 (Fed. Cir. 1997))).

14. *See supra* notes 7–8 and accompanying text.

themselves cannot be practiced without securing licenses to use other patented technology. In order to grant and obtain access to patents, license agreements must be structured to define clearly the scope of protection under a patent for both the patent owner, as licensor, and the party seeking to use the patented invention, as licensee.

A license agreement must, at a minimum, clearly define the rights and obligations of each party, as well as the available remedies for breach of an obligation. License agreements generally rely on contract and tort law to enforce the promises of the parties and the reasonable conduct of the parties.<sup>15</sup> Patent license agreements additionally seek to enforce the law of patents. Because a patent does not confer a positive right to exploit the patent, a patent license cannot grant any such right.<sup>16</sup> In effect, a patent license is only an agreement by the licensor that it will not enforce its right of exclusion against the licensee. Thus, a central task of a patent license is to strike a balance between the competing demands of many different areas of law, including contracts, torts, and patents. Antitrust and constitutional considerations often enter into the mix, as well.<sup>17</sup>

## II. THE HISTORICAL LANDSCAPE OF PATENT CHALLENGES UNDER LICENSES

*MedImmune* was not the first time the Supreme Court tried to strike an acceptable balance between diverging areas of law. The tension between holding a party to its contract and not allowing invalid or overbroad patents to exist is as old as patent license agreements themselves. This time around, the Supreme Court has weighed in on the side of the contract-abiding patent challenger. In order to understand the metes and bounds of the *MedImmune*

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15. See, e.g., *Pure Bioscience v. Ross Sys.*, No. 07-CV-1117, 2008 U.S. Dist. LEXIS 28454, at \*6-7 (S.D. Cal Apr. 7, 2004).

16. See *Bloomer v. McQuewan*, 55 U.S. 539, 549 (1853).

17. See, e.g., *Walker Process Equip., Inc. v. Food Mach. and Chem. Corp.*, 382 U.S. 172 (1965) (holding that the knowing assertion of patents that were procured by fraud can be the basis for a claim of monopolization or attempted monopolization under the Sherman Act, 15 U.S.C. § 2); *Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49 (1993) (holding that a party that engages in "sham litigation" that is objectively baseless may violate the antitrust laws). Patent assertions against state entities can raise questions of sovereign immunity under the Eleventh Amendment. See generally *Florida Prepaid Postsecondary Educ. Expense Bd. v. College Sav. Bank*, 527 U.S. 627 (1999); *Biomedical Patent Mgmt. Corp. v. California*, 505 F.3d 1328 (Fed. Cir. 2007).

decision and its progeny, a review of the historical push-and-pull of the policy considerations that have influenced decisions on patents and patent licenses made by the courts is essential.

In 1969, the Supreme Court held in *Lear, Inc. v. Adkins* that a licensee is not estopped from challenging a patent's validity in an infringement action brought by the licensor/patentee as the result of a breach of the patent license.<sup>18</sup> In so holding, the Court struck a balance between the competing demands of contract law, since it fostered the parties' agreements, and the public interest, since it ensured that invalid patents did not prevent the practicing of ideas that should be in general circulation. The Court favored protection of the public interest over patent protection in opining that licensees should not be required to continue to pay royalties under a license while challenging patent validity.<sup>19</sup>

The relevant facts of the *Lear* case are as follows: In 1952, Lear, Inc., hired John Adkins, an engineer, to develop improvements to gyroscopes for use in airplanes.<sup>20</sup> The parties agreed that Adkins would be the owner of any inventions relating to his work, and that Adkins would grant a license to Lear on mutually agreeable terms.<sup>21</sup> In 1954, Adkins filed a patent application relating to his work for Lear.<sup>22</sup> In 1955, the parties entered into a license agreement that required Lear to pay royalties for the use of Adkins' invention.<sup>23</sup> The royalties depended on whether Adkins received a patent and on the validity of any issued patent.<sup>24</sup> Adkins eventually received a patent in 1960.<sup>25</sup> During the pendency of Adkins' patent application, however, Lear developed the belief that Adkins' invention was not entitled to a patent in view of prior art<sup>26</sup>—that is, previously-known gyroscope technology. As a result, Lear stopped paying royalties before Adkins received his patent.<sup>27</sup>

After receiving his patent, Adkins sued Lear in California state court for breach of contract.<sup>28</sup> Lear argued, in defense, that the patent was invalid because the patented invention had been known in the prior art, and that Adkins should not be able to demand

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18. 395 U.S. 653, 670–71 (1969).

19. *Id.* at 673–74.

20. *Id.* at 655.

21. *Id.* at 657.

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.* at 658.

26. *Id.* at 659.

27. *Id.* at 659–60.

28. *Id.* at 660.

royalties for technology that did not merit patent protection.<sup>29</sup> Adkins argued that Lear, as a licensee, was estopped from challenging the validity of the licensed patent. The California Supreme Court sided with Adkins.<sup>30</sup> The U.S. Supreme Court reversed, holding: "Lear must be permitted to avoid the payment of all royalties accruing after Adkins' 1960 patent issued if Lear can prove patent invalidity."<sup>31</sup> In so holding, the Court cited the public policy favoring the full and free use of ideas in the public domain.<sup>32</sup> The *Lear* decision left open the question of the circumstances under which a licensee could take advantage of the Court's abolishment of licensee estoppel. Applying *Lear* to subsequent decisions would prove to be difficult.<sup>33</sup> The following Sections discuss the Court's decisions in this area of the law.

#### A. Studiengesellschaft Kohle M.B.H. v. Shell Oil Company

In 1997, the Court of Appeals for the Federal Circuit considered the *Lear* doctrine in *Studiengesellschaft Kohle M.B.H. v. Shell Oil Co.*<sup>34</sup> The relevant facts of this case are as follows: Studiengesellschaft Kohle M.B.H. ("SGK") licensed to Shell a number of patents relating to the production of polypropylene.<sup>35</sup> At one plant, Shell employed a process that Shell believed did not use SGK's patented technology, and Shell did not pay royalties for polypropylene manufactured at that plant.<sup>36</sup> SGK brought an action against Shell for unpaid royalties and patent infringement.<sup>37</sup> During the litigation, Shell asserted that SGK's patent was invalid in view of prior art.<sup>38</sup> The trial court found SGK's patent to be invalid.<sup>39</sup> On appeal, the Federal Circuit considered whether SGK could recover damages for breach of contract for past royalties owing from the date of the alleged breach until Shell first challenged the validity of the claims.<sup>40</sup>

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29. *Id.*

30. *Adkins v. Lear, Inc.*, 435 P.2d 321, 336 (Cal. 1967).

31. *Lear*, 395 U.S. at 674.

32. *Id.* ("Lastly, enforcing this contractual provision would undermine the strong federal policy favoring the full and free use of ideas in the public domain.").

33. *See infra* pp. 237-245.

34. 112 F.3d 1561 (Fed. Cir. 1997).

35. *Id.* at 1563.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 1562.



In applying *Lear* to the facts of the case, the Federal Circuit stated: "[T]his court detects no significant frustration of federal patent policy by enforcing the 1987 license agreement between Shell and SGK, to the extent of allowing SGK to recover royalties until the date Shell first challenged the validity of the claims."<sup>41</sup> The Federal Circuit held that a licensee could not invoke the *Lear* doctrine and challenge validity affirmatively or in defense until it had "(i) cease[d] payment of royalties, and (ii) provide[d] notice to the licensor that the reason for ceasing payment of royalties is because it ha[d] deemed the relevant claims to be invalid."<sup>42</sup> In the court's view, this ruling was necessary to "prevent the injustice of allowing Shell to exploit the protection of the contract and patent rights and then later to abandon conveniently its obligations under those same rights."<sup>43</sup>

### B. Gen-Probe Inc. v. Vysis, Inc.

In 2004, the Federal Circuit followed the logic of the *Studiengesellschaft* ruling in *Gen-Probe Inc. v. Vysis, Inc.*<sup>44</sup> In June of 1999, Vysis granted Gen-Probe a license for a patent relating to nucleic acid diagnostic assays.<sup>45</sup> In December of 1999, Gen-Probe filed a lawsuit seeking a declaratory judgment of noninfringement and, later, unenforceability.<sup>46</sup> Even after filing suit, however, Gen-Probe continued paying royalties to Vysis, although under protest.<sup>47</sup> Vysis filed a motion to dismiss the lawsuit for lack of subject-matter jurisdiction, arguing that Gen-Probe could not have a reasonable apprehension of being sued for patent infringement because it was a licensee in good standing.<sup>48</sup> The district court denied Vysis' motion.<sup>49</sup> After a trial, the district court entered a judgment that Vysis' patent was invalid and had not been infringed.<sup>50</sup>

On appeal, the Federal Circuit considered the district court's denial of Vysis' motion to dismiss the lawsuit for lack of subject-matter jurisdiction.<sup>51</sup> The court held that a licensee who was still

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41. *Id.* at 1568.

42. *Id.*

43. *Id.*

44. 359 F.3d 1376 (Fed. Cir. 2004). Gen-Probe was a patent licensee for blood screening technology, to which Vysis owned the patent.

45. *Id.* at 1377-78.

46. *Id.* at 1378.

47. *Id.*

48. *Id.* at 1379.

49. *Id.*

50. *Id.*

51. *Id.* at 1377.

operating under the license and paying royalties, albeit under protest, could not bring a declaratory judgment action challenging patent validity.<sup>52</sup> The Federal Circuit held that because Gen-Probe was a licensee in good standing, it had no reasonable apprehension of a lawsuit.<sup>53</sup> Indeed, Vysis, the licensor/patent owner, had not and could not have sued Gen-Probe for breach of the license agreement;<sup>54</sup> in fact, the court observed that allowing Gen-Probe's declaratory judgment action to go forward while the license was in effect would have the undesirable consequence that the license would serve as an "effective cap on damages or royalties" in the event its patent challenge failed.<sup>55</sup> The Federal Circuit deemed this to be an undesirable imbalance of risk between licensor and licensee.<sup>56</sup>

### C. MedImmune v. Genentech: Patent Licensees Rise to Power

Last year, the Supreme Court considered the *Gen-Probe* decision when deciding *MedImmune*.<sup>57</sup> The facts of *MedImmune* were as follows: In 1997, Genentech granted a license to MedImmune.<sup>58</sup> "The license covered an existing patent relating to the production of 'chimeric antibodies' and a then-pending patent application relating to 'the coexpression of immunoglobulin chains in recombinant host cells.'"<sup>59</sup> In December of 2001, the pending patent application matured into a patent.<sup>60</sup> Genentech believed that MedImmune's drug, Synagis, infringed the newly issued patent and demanded that MedImmune pay royalties for this patent.<sup>61</sup> MedImmune believed that the patent was invalid and unenforceable, but paid royalties under protest.<sup>62</sup> MedImmune later filed a declaratory judgment lawsuit against Genentech.<sup>63</sup> The district court dismissed the lawsuit for lack of subject-matter jurisdiction, citing the *Gen-Probe* decision, and the Federal Circuit affirmed.<sup>64</sup>

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52. *Id.* at 1381.

53. *Id.* ("In other words, the license insulated Gen-Probe from an infringement suit instituted by Vysis.")

54. *Id.* at 1381-82.

55. *Id.* at 1382.

56. *Id.*

57. *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007).

58. *Id.* at 767-68.

59. *Id.* at 768.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

The Supreme Court granted certiorari, reversed the decision of the Federal Circuit, and overruled *Gen-Probe*.<sup>65</sup> The Court held that a patent licensee in good standing has subject-matter jurisdiction, under the “actual controversy” requirement of the Declaratory Judgment Act,<sup>66</sup> to file a declaratory judgment action against the licensor/patentee.<sup>67</sup> The Court reasoned that the coercive effect of a breach of the license and possible subsequent injunction under the patent provided a sufficient case or controversy.<sup>68</sup>

Before *MedImmune*, a declaratory judgment action could go forward only if a patent licensee or prospective licensee could show that it had a “reasonable apprehension” that the patent owner would sue the licensee or prospective licensee for patent infringement.<sup>69</sup> The Federal Circuit’s “reasonable apprehension of suit” test entailed two parts: first, a consideration of whether conduct by the patent owner created a reasonable apprehension on the part of the declaratory judgment plaintiff (the licensee) that it would face an infringement suit; and second, an examination of whether conduct by the plaintiff either amounted to infringing activity or else demonstrated a definite intent to conduct such activity. If both of these prongs were satisfied, jurisdiction attached.<sup>70</sup>

The reasonable apprehension test was meant to serve as a proxy to determine whether a justiciable case or controversy existed in patent cases.<sup>71</sup> The controversy requirement was met when the declaratory judgment plaintiff had demonstrated sufficient interest in the controversy and there was a reasonable threat that the patent owner or licensor would bring an infringement suit against the plaintiff as alleged infringer.<sup>72</sup>

In practice, however, the reasonable apprehension test was difficult to apply, in no small part because its two core elements both

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65. *Id.* at 777.

66. The Declaratory Judgment Act provides that “[i]n a case of actual controversy within its jurisdiction . . . any court of the United States . . . may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought.” 28 U.S.C. § 2201(a). The Supreme Court has clarified that the phrase “case or actual controversy” in the Declaratory Judgment Act refers to the type of cases and controversies that are justiciable. *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240–41 (1937).

67. *MedImmune*, 127 S. Ct. at 777.

68. *Id.* at 773–74.

69. *Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376, 1379–80 (Fed. Cir. 2004).

70. *See, e.g.*, *BP Chemicals Ltd. v. Union Carbide Corp.*, 4 F.3d 975, 978 (Fed. Cir. 1993); *Arrowhead Indus. Water, Inc. v. Ecolochem, Inc.*, 846 F.2d 731, 736 (Fed. Cir. 1988).

71. *See, e.g.*, *Gen-Probe*, 359 F.3d at 1379–80.

72. *See C.R. Bard, Inc. v. Schwartz*, 716 F.2d 874, 879 (Fed. Cir. 1983).

turned on evidence of fairly broad and amorphous intent: a demonstrated intent by the defendant to enforce its patent and a demonstrated intent by the plaintiff to undertake potentially infringing activity. The second element of the test often proved particularly nettlesome given the range of potential behavior attributable to “meaningful” preparation to engage in infringing activity.<sup>73</sup> The stringency of the test for the plaintiff is noted in the evolution of the test’s name itself, to the “reasonable apprehension of imminent suit” test.<sup>74</sup> Without a more easily met and clear-cut standard, licensees were often reluctant to bring suit. As a result, patent owners usually ended up controlling whether, when, and where litigation occurred, giving patent owners the initial tactical advantage of choosing the venue for litigation.

In *MedImmune*, the Supreme Court criticized this patent-friendly jurisprudence and took the reasonable apprehension test to task. The Court cast doubt on the value of the test in the context of a dispute in which a license agreement was already in place.<sup>75</sup> The Court ruled that the licensee, MedImmune, did not have to breach or terminate the license agreement it had entered into with the licensor/patent owner, Genentech, before bringing an action to challenge the validity and enforceability of a licensed patent application after it had issued as a patent.<sup>76</sup> The Court reversed the Federal Circuit’s affirmance of the dismissal of MedImmune’s declaratory judgment action, noting that the Federal Circuit’s “reasonable apprehension of suit” test conflicted with Supreme Court precedent in other non-patent arenas for assessing whether a justiciable controversy exists.<sup>77</sup> The Court loosened the controversy requirement to realign itself with the controversy standard in non-patent jurisprudence and, in so doing, embraced the notion that both implicit and explicit threats by the patent owner can establish declaratory judgment jurisdiction.<sup>78</sup>

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73. See, e.g., *Arrowhead*, 846 F.2d at 736 (noting that “sufficient ‘preparation’” is necessarily “a question of degree to be resolved on a case-by-case basis”).

74. See *Teva Pharms. USA, Inc. v. Pfizer, Inc.*, 395 F.3d 1324, 1333–34 (Fed. Cir. 2005).

75. *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764, 774 n.11, 775–76 (2007).

76. *Id.* at 776 (“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.” (emphasis omitted)).

77. *Id.* at 774 n.11.

78. *Id.* at 772 (ruling that the elimination of the imminent threat of prosecution does not eliminate Article III jurisdiction); see generally Donald S. Chisum,

Under *MedImmune*, a federal court may entertain a lawsuit by a patent licensee challenging a licensed patent even if the licensee is still paying royalties.<sup>79</sup> As such, the ruling potentially alters the balance of power between patent owners and their licensees by giving licensees more control over potential litigation. The ruling also inherently sought to balance the competing demands of constitutional, contract, and patent laws—between holding a party to its contract and not allowing invalid or overbroad patents to exist. The *MedImmune* decision resolved one question relating to the interplay between these different areas of law, but it left other important questions unanswered—for example, when an actual controversy for purposes of declaratory judgment jurisdiction exists in the absence of a patent license.

At first blush, one contractual solution to this new jurisprudence might seem evident to aggressive patent owners: Why not recalibrate the pro-licensee impact of *MedImmune* by including a provision in future patent licenses to prohibit a party to the agreement from seeking to invalidate or otherwise challenging the validity of any licensed patent? After all, the Supreme Court focused on the contractual element of the license in *MedImmune*, which required the licensee to pay for products that would infringe claims of the patent, to hold that the licensee could seek a judgment of patent validity without repudiating the license.<sup>80</sup> However, patent owners as potential licensors should be mindful of the common-law rule, specifically *not* overruled by *MedImmune*, which calls into question a patent owner's ability to contract out the ability of a licensee to contest the validity or otherwise challenge a licensed patent.<sup>81</sup>

After *MedImmune*, patent licensors can no longer rest under the protective umbrella of *Gen-Probe* to assure themselves that only licensees who stop paying royalties can challenge the licensed patent in a declaratory judgment action. Now, licensees can challenge the validity of the licensed patents without repudiating the license and while continuing to use the licensed invention, simply by continuing to pay royalties to the licensor either "under protest" or

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*Licensee Challenges to Patent Validity After MedImmune*, Feb. 7, 2007, <http://www.chisum.com/MedImmuneWebPost.pdf>.

79. *MedImmune*, 127 S. Ct. at 777.

80. *Id.* at 775–77.

81. See *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969) (stating that the "spirit of contract law . . . seeks to balance the claims of promisor and promise in accord with the requirements of good faith").

with the "reservation of rights."<sup>82</sup> In sum, the licensee can challenge the licensor's patent without facing possible damages for breaching the license agreement and without facing possible infringement damages for continuing to use the licensed invention. The licensee is sitting pretty under *MedImmune*.

By contrast, the *MedImmune* decision markedly lowered the expectations of the licensor/patentee and the rights it enjoys under a patent. Allowing a licensee in good standing to challenge a patent puts all of the risks on the patent owner. If the patentee loses, the license ends. If the patentee wins, the license continues under the same terms. The licensee, on the other hand, is free to challenge the patent, immune from suit and with little downside except having to continue to pay royalties during the challenge, albeit thereby funding the defense. Under this rule, as noted by the licensor in *MedImmune*, a licensee has essentially purchased an insurance policy to immunize it from suits for infringement so long as it continues to pay royalties.<sup>83</sup> As a result, the *MedImmune* decision fundamentally shifted the balance of the suit to the licensee and away from the patent owner. How will *MedImmune* affect licensing negotiations going forward? A recent Federal Circuit case answers this question with respect to the rights of prospective licensees as parties to licensing negotiations.

#### D. SanDisk v. STMicroelectronics: Potential Licensees Stake a Claim

On the heels of *MedImmune*, the Federal Circuit issued a decision that enhanced the ability of *prospective* licensees to establish jurisdiction by bringing declaratory judgment actions. In further application of the Supreme Court's *MedImmune* guidance, in *SanDisk Corp. v. STMicroelectronics, Inc.*, the Federal Circuit held that the reasonable apprehension test had been eradicated.<sup>84</sup>

*SanDisk* involved a fairly typical situation where STMicroelectronics, the patent owner, and SanDisk, a prospective licensee, engaged in licensing discussions over a period of six months.<sup>85</sup> STMicroelectronics asserted that SanDisk infringed fourteen of its patents and presented information purporting to show how these patents covered SanDisk's products.<sup>86</sup> During negotiations,

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82. *MedImmune*, 127 S. Ct. at 777 (holding that breaking or terminating a license agreement is not a necessary prerequisite to seeking a declaratory judgment in federal court of patent invalidity, unenforceability, or non-infringement).

83. See *id.* at 775–76.

84. 480 F.3d 1372, 1380 (Fed. Cir. 2007).

85. *Id.* at 1374–76.

86. *Id.* at 1375.

STMicroelectronics went so far as to state that “ST has absolutely no plan whatsoever to sue SanDisk.”<sup>87</sup> SanDisk eventually filed a declaratory judgment action alleging that the fourteen patents STMicroelectronics sought to license were invalid and further explaining how SanDisk did not infringe these patents if valid.<sup>88</sup> The district court found that SanDisk did not have a reasonable apprehension of suit and dismissed the action.<sup>89</sup>

On appeal, the Federal Circuit directly addressed *MedImmune* and confirmed that the reasonable apprehension test was no longer viable for determining declaratory judgment jurisdiction.<sup>90</sup> With this guidance, the Federal Circuit found that SanDisk had sufficient grounds for bringing a declaratory judgment action seeking to invalidate a patent.<sup>91</sup> The *SanDisk* court held that the actual controversy needed to support a declaratory judgment action was satisfied when two parties reached adverse legal positions regarding potentially infringing activities, even if the patent owner expressly disclaimed any intention to sue and even if these positions were only made during negotiations, for example, as potential licensor and potential licensee.<sup>92</sup> The court did not articulate a standard for determining declaratory judgment jurisdiction in all patent cases, stating that it was not defining the outer boundaries of declaratory judgment jurisdiction.<sup>93</sup>

While *SanDisk* did not result in the creation of a general standard for all patent cases, the decision makes clear that prospective licensees also now have more freedom to initiate challenges to patents in the courts. The *SanDisk* decision makes clear that once a patent owner asserts its rights based on the ongoing or planned activity of another party, the other party does not need a license to challenge the patent; so long as the other party contends that it has the right to engage in the accused activity without a license, jurisdiction attaches.<sup>94</sup> The *SanDisk* decision, in effect, stands for the rule that declaratory judgment jurisdiction exists for virtually any situation in which a patentee engages a prospective licensee in licensing discussions and the prospective licensee disagrees with the patentee about the need for a license—that is, because of noninfringement

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87. *Id.* at 1376.

88. *Id.*

89. *Id.* at 1376–77.

90. *Id.* at 1380.

91. *Id.* at 1381–82.

92. *Id.* at 1382.

93. *Id.* at 1381.

94. *Id.*

or invalidity. Moreover, one can read the decision to suggest that in typical patent licensing scenarios like the one considered in *SanDisk*, district courts should not refuse to hear the prospective licensee's patent challenge.

One of the Federal Circuit judges who decided *SanDisk* issued a concurring opinion that expressed concern about the scope of the court's holding and predicted that it "will effect a sweeping change in our law regarding declaratory judgment jurisdiction."<sup>95</sup> In his concurrence, Judge Bryson maintained his reservations with this path with "no practical stopping point," but acknowledged that the Supreme Court's *MedImmune* decision compelled it.<sup>96</sup> Accordingly, this "sweeping change" must now enter into the calculations of parties to licensing negotiations, as well as parties considering whether and how to engage in licensing negotiations.

Specific manifestations and consequences of this "sweeping change" will emerge over time, but some considerations are apparent now. Patent licenses will be less effective in forestalling litigation, adding instability to anticipated licensing relationships and revenue streams. Nevertheless, licensees will more readily enter into patent licenses, although licensees should be aware that patent owners might begin negotiating more aggressively to include provisions to deter licensees from later challenging the licensed patent.

Forewarned is forearmed. Patentees and prospective licensees will necessarily change the way they communicate with each other.<sup>97</sup> With the threshold for declaratory judgment jurisdiction lowered, many prospective licensees will communicate with patentees in a way that attempts to engineer grounds for a lawsuit—the result predicted by Judge Bryson in his concurring opinion in *SanDisk*.<sup>98</sup> Both sides to potential licensing negotiations will be more likely to sue than to negotiate.

### III.

#### NEGOTIATING THE NEW RULES OF THE GAME

The specter of the *MedImmune* and *SanDisk* holdings have kicked open the courthouse door for both licensees and prospective licensees. In appropriate circumstances, a prospective patent licensee can file a lawsuit against a patentee and request a declara-

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95. *Id.* at 1385 (Bryson, J., concurring).

96. *Id.*

97. The *SanDisk* decision, for example, noted that the patentee could have avoided declaratory judgment jurisdiction with a suitable confidentiality agreement. *Id.* at 1375 n.1.

98. *Id.* at 1385.



tory judgment that the patent sought to be licensed is invalid, unenforceable, and/or not infringed. The roadblocks that previously stood in the path of a prospective licensee who wanted to challenge a patent it was being asked to license have been removed. The *SanDisk* decision, coupled with *MedImmune*, makes clear that patent owners are becoming increasingly vulnerable to patent challenges by licensees and prospective licensees alike, and on the patent challenger's terms.

The effects of *MedImmune* and *SanDisk* are likely to increase both patent litigation and patent licensing, or at least licensing negotiations, as licensees have more to gain and less to lose under the shift in the law brought about by these decisions. Patent owners do not always have the means to practice the full breadth of their patent portfolios, so it is hardly a realistic option for patent owners to hold back their patents from licensing discussions. Moreover, individuals and companies commonly need the revenue brought by patent licensing deals to invest in the research and development of patentable technology and future improvements on that technology. Patents need to be licensed. It is not an overstatement to say that patents and licenses cannot exist without each other.

*MedImmune* and *SanDisk* may prove especially damaging to small technology-based companies and research institutions that own patents. They need early licensing to encourage others to bring their ideas, and products based on them, to the market—yet they also need the financial rewards of those future product sales to fund research. The *MedImmune* line of cases throws into doubt the expectations of future rewards for products that are years from being commercialized. Now, companies can enter into early licenses to get their hands on important technology and promise to share the future profits of the endeavor. However, when the ship sets sail and the profits begin rolling in, the licensee can challenge the patent. If patents can be so easily challenged once investments have been made, and possibly exclusive licenses procured, any reliable expectation of a future effective term of patent protection (and a consequent stream of revenue) is diminished. Indeed, the threat of challenge alone may be enough to force the licensor to reduce the long-before agreed-to royalty.

## CONCLUSION

The substantive and procedural contours of *MedImmune* and *SanDisk* have carved a new legal landscape for both patent litigators and licensors. Jurisprudential holes in the landscape remain to be filled in. Going forward, therefore, patent owners and prospective

licensees need to monitor the case law following *MedImmune* and *SanDisk* to determine how to engage in licensing discussions, how to structure licensing agreements, and when to file suit, if necessary. While these cases may serve to fuel more patent licenses and patent litigation, the value of any patent is only as strong as the patent system itself. If a patent fails to provide effective and clear rights for any commercially viable period, efforts made in licensing negotiations and litigation will be fruitless.

"Patent reform" is the current watchword in Congress, and change is on the agenda.<sup>99</sup> In the midst of this restructuring, it is important to keep in mind that the patent system is a two-way street. In order to provide value to society, individuals and companies need to buy into, leverage, and transfer patented technology. Patent owners need funding to develop and improve upon their patented technology. Patent licensees need access to this technology to garner a foothold in an industry. A measure of reliability must be maintained in the patent system and in the value and enforcement duration of patents in order to assure the economic importance of patents and the underlying technology. Overprotection of patents or patent licenses impedes free market competition, but an undervaluation of such is equally injurious to the creation of profitable inventions.

The long-term effect of the newfound power bestowed (or rather, re-bestowed) upon patent licensees and potential patent licensees should be to encourage licensing negotiations and facilitate more patent licenses. Patent holders may well benefit from increased licenses and increased royalties for at least some term, while potential licensees will feel more emboldened to terminate licensing negotiations that appear unproductive. As a lasting effect, patent licensees should recognize the important role they play in the patent system as investors to attract future funding for companies. As such, patent licensees should not rush to challenge patents without good cause. Patent licensees and potential licensees should also be mindful in their communications with patent holders to recognize that any strategy leading to the courthouse door is one that has the potential to result in a further recalibration of power between patent holders and challengers.

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99. Patent Reform Act of 2007, H.R. 1908, 110th Cong. (2007); Patent Reform Act of 2007, S. 1145, 110th Cong. (2008).

