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Estoppel and No-Challenge Clauses

SUMMARY CONTENTS

What happens when an intellectual property (IP) license is granted, but the underlying IP is later found to be invalid? Is the license still in effect? More importantly, is the licensee still required to pay for it? The answer to these questions is generally "no." Invalid IP is a legal nullity that cannot be licensed. Moreover, as we will see in Section 24.3, an IP holder commits misuse if it tries to charge royalties after a patent or copyright expires.

But when IP is licensed, who has the greatest incentive to challenge the validity of that IP? Validity challenges are often brought by infringers who are threatened or sued by the IP owner. But what if the infringers have all taken licenses? In many cases, the most logical, if not the only, party with an incentive and standing to challenge an IP right is one of its existing licensees, especially if that licensee is obligated to pay ongoing royalties for the continued use of that IP right.

It thus becomes important to understand when the licensee of an IP right can challenge the validity of licensed IP. And, if such challenges are *legally* permitted, can the licensee be *contractually* prohibited from making such a challenge? These seemingly straightforward questions have been the subject of extensive litigation and implicate the very foundations of IP law itself. In this chapter we will review the doctrines of assignor and licensee estoppel, then review the requirements for challenging licensed IP under the Declaratory Judgment Act. We conclude with a discussion of contractual clauses that limit IP challenges by licensees in agreements licensing patents, copyrights and trademarks.

22.1 ASSIGNOR ESTOPPEL

To understand the restraints on a licensee's ability to challenge IP that it has licensed, it is instructive to consider a related doctrine – assignor estoppel. This doctrine, which originated in England in the late eighteenth century, provides that one who sells a patent for valuable consideration may not thereafter challenge the validity of the patent that it has sold.[1] The idea harkens back to the

[1] For a review of these historical cases, see William C. Rooklidge, *Licensee Validity Challenges and the Obligation to Pay Accrued Royalties: Lear v. Adkins Revisited* – Part 1, 68 J. Pat. & Trademark Off. Soc'y 506, 508–12 (1986).

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real property doctrine of "estoppel by deed," which holds that a seller of property by deed cannot later assert defects in the deed to claim back any right in the property. In effect, it prevents a seller from profiting by its own dishonesty. The Supreme Court recently revisited this ancient doctrine.

Minerva Surgical, Inc. v. Hologic, Inc.

210 L. Ed. 2d 689 (U.S. 2021)

KAGAN, JUSTICE[2]

In *Westinghouse Elec. & Mfg. Co. v. Formica Insulation Co.*, 266 U. S. 342 (1924), this Court approved the "well settled" patent-law doctrine of "assignor estoppel." That doctrine, rooted in an idea of fair dealing, limits an inventor's ability to assign a patent to another for value and later contend in litigation that the patent is invalid. The question presented here is whether to discard this century-old form of estoppel. Continuing to see value in the doctrine, we decline to do so. But in upholding assignor estoppel, we clarify that it reaches only so far as the equitable principle long understood to lie at its core. The doctrine applies when, but only when, the assignor's claim of invalidity contradicts explicit or implicit representations he made in assigning the patent.

I

The invention sparking this lawsuit is a device to treat abnormal uterine bleeding, a medical condition affecting many millions of women. Csaba Truckai, a founder of the company Novacept, Inc., invented the device—called the NovaSure System—in the late 1990s. He soon afterward filed a patent application, and assigned his interest in the application—as well as in any future "continuation applications"—to Novacept. The NovaSure System, as described in Truckai's patent application, uses an applicator head to destroy targeted cells in the uterine lining. To avoid unintended burning or ablation (tissue removal), the head is "moisture permeable," meaning that it conducts fluid out of the uterine cavity during treatment. The PTO issued a patent, and in 2001 the Food and Drug Administration (FDA) approved the device for commercial distribution. But neither Truckai nor Novacept currently benefits from the NovaSure System patent. In 2004, Novacept sold its assets, including its portfolio of patents and patent applications, to another company (netting Truckai individually about $8 million). And in another sale, in 2007, respondent Hologic, Inc. acquired all patent rights in the NovaSure System. Today, Hologic sells that device throughout the United States.

Not through with inventing, Truckai founded in 2008 petitioner Minerva Surgical, Inc. There, he developed a supposedly improved device to treat abnormal uterine bleeding. Called the Minerva Endometrial Ablation System, the device (like the NovaSure System) uses an applicator head to remove cells in the uterine lining. But the new device, relying on a different way to avoid unwanted ablation, is "moisture impermeable": It does not remove any fluid during treatment. The PTO issued a patent for the device, and in 2015 the FDA approved it for commercial sale.

Meanwhile, in 2013, Hologic filed a continuation application requesting to add claims to its patent for the NovaSure System. Aware of Truckai's activities, Hologic drafted one of

[2] Justices Barrett, Gorsuch and Thomas dissented from the majority's opinion, largely on historical statutory interpretation grounds. Justice Alito dissented separately on different grounds.

those claims to encompass applicator heads generally, without regard to whether they are moisture permeable. The PTO in 2015 issued the altered patent as requested.

A few months later, Hologic sued Minerva for patent infringement. Minerva rejoined that its device does not infringe. But more relevant here, it also asserted that Hologic's amended patent is invalid. The essential problem, according to Minerva, is that the new, broad claim about applicator heads does not match the invention's description, which addresses their water-permeability. In response, Hologic invoked the doctrine of assignor estoppel. Because Truckai assigned the original patent application, Hologic argued, he and Minerva (essentially, his alter-ego) could not impeach the patent's validity. The District Court agreed that assignor estoppel barred Minerva's invalidity defense, and also ruled that Minerva had infringed Hologic's patent. At a trial on damages, a jury awarded Hologic about $5 million.

The Court of Appeals for the Federal Circuit mainly upheld the judgment, focusing on assignor estoppel. The court first "decline[d] Minerva's invitation to 'abandon [that] doctrine.'" Citing both this Court's precedents and equitable principles, the court affirmed the doctrine's "continued vitality." An assignor, the court stated, "should not be permitted to sell something and later to assert that what was sold is worthless, all to the detriment of the assignee." The assignor makes an "implicit representation" that the rights "he is assigning (presumably for value) are not worthless." It would "work an injustice," the court reasoned, to "allow the assignor to make that representation at the time of assignment (to his advantage) and later to repudiate it (again to his advantage)." The court then applied assignor estoppel to bar Truckai and Minerva from raising an invalidity defense. Here, the court rejected Minerva's argument that because "Hologic broadened the claims" after "Truckai's assignment," it would "be unfair to block Truckai (or Minerva) from challenging the breadth of those claims." Relying on circuit precedent, the court deemed it "irrelevant that, at the time of the assignment, the inventor's patent application[] w[as] still pending" and that the assignee "may have later amended the claims" without the inventor's input.

We granted certiorari to consider the important issues raised in the Federal Circuit's judgment. Assignor estoppel, we now hold, is well grounded in centuries-old fairness principles, and the Federal Circuit was right to uphold it. But the court failed to recognize the doctrine's proper limits. The equitable basis of assignor estoppel defines its scope: The doctrine applies only when an inventor says one thing (explicitly or implicitly) in assigning a patent and the opposite in litigating against the patent's owner.

II

Courts have long applied the doctrine of assignor estoppel to deal with inconsistent representations about a patent's validity. The classic case (different in certain respects from the one here) begins with an inventor who both applies for and obtains a patent, then assigns it to a company for value. Later, the inventor/assignor joins a competitor business, where he develops a similar—and possibly infringing—product. When the assignee company sues for infringement, the assignor tries to argue—contrary to the (explicit or implicit) assurance given in assigning the patent—that the invention was never patentable, so the patent was never valid. That kind of about-face is what assignor estoppel operates to prevent—or, in legalese, estop. As one of the early American courts to use the doctrine held: The assignor is not "at liberty to urge [invalidity] in a suit upon his own patent against a party who derives title to that patent through him." Woodward v. Boston Lasting Mach. Co., 60 F. 283, 284 (CA1 1894). Or as the Federal Circuit held in modern times:

The assignor's explicit or "implicit representation" that the patent he is assigning is "not worthless … deprive[s] him of the ability to challenge later the [patent's] validity."

Assignor estoppel got its start in late 18th-century England and crossed the Atlantic about a hundred years later. In the first recorded case, Lord Kenyon found that a patent assignor "was by his own oath and deed estopped" in an infringement suit from "attempt[ing] to deny his having had any title to convey." That rule took inspiration from an earlier doctrine—estoppel by deed—applied in real property law to prevent a conveyor of land from later asserting that he had lacked good title at the time of sale. Lord Kenyon's new patent formulation of the doctrine grew in favor throughout the 1800s as an aspect of fair dealing: When "the Defendant sold and assigned th[e] patent to the Plaintiffs as a valid one," it "does not lie in his mouth to say that the patent is not good." Within a decade or two, the doctrine was "so well established and generally accepted that citation of authority is useless."

This Court first considered—and unanimously approved—assignor estoppel in 1924, in *Westinghouse v. Formica*. Speaking through Chief Justice Taft, the Court initially invoked the doctrine's uniform acceptance in the lower courts. The first decision applying assignor estoppel, the Court recounted, was soon "followed by a myriad." "[L]ater cases in nearly all the Circuit Courts of Appeal" were "to the same point" as the first, adding up to a full "forty-five years of judicial consideration and conclusion." Such a "well settled" rule, in the Court's view, should "not [be] lightly disturb[ed]." And so it was not disturbed, lightly or otherwise. Rather, the Court added its own voice to that pre-existing "myriad." We announced that an assignor "is estopped to attack" the "validity of a patented invention which he has assigned." "As to the rest of the world," the Court explained, "the patent may have no efficacy"; but "the assignor can not be heard to question" the assignee's rights in what was conveyed.

Westinghouse, like its precursor decisions, grounded assignor estoppel in a principle of fairness. "If one lawfully conveys to another a patented right," the Court reasoned, "fair dealing should prevent him from derogating from the title he has assigned." After all, the "grantor purports to convey the right to exclude others"; how can he later say, given that representation, that the grantee in fact possesses no such right? The Court supported that view of equity by referring to estoppel by deed. Under that doctrine, the Court explained, "a grantor of a deed of land" cannot "impeach[] the effect of his solemn act" by later claiming that the grantee's title is no good. *Westinghouse*, 266 U. S., at 350. "The analogy" was "clear": There was "no reason why the principles of estoppel by deed should not apply to [the] assignment of a patent right." In the latter context too, the Court held, the assignor could not fairly "attack" the validity of a right he had formerly sold.

After thus endorsing assignor estoppel, the Court made clear that the doctrine has limits. Although the assignor cannot assert in an infringement suit that the patent is invalid, the Court held that he can argue about how to construe the patent's claims. Here, the Court addressed the role in patent suits of prior art—the set of earlier inventions (and other information) used to decide whether the specified invention is novel and non-obvious enough to merit a patent. "Of course," the Court said, the assignor cannot use prior art in an infringement suit "to destroy the patent," because he "is estopped to do this." But he can use prior art to support a narrow claim construction—to "construe and narrow the claims of the patent, conceding their validity." "Otherwise," the Court explained, a judge "would be denied" the "most satisfactory means" of "reaching a just conclusion" about the patent's scope—a conclusion needed to resolve the infringement charge. "The distinction"

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thus established, the Court thought, "may be a nice one, but seems to be workable." And, indeed, the Court applied it to decide the case at hand for the assignor, finding that he had not infringed the properly narrowed claim.

Finally, the Court left for another day several other questions about the contours of assignor estoppel. One concerned privity: When was an assignor so closely affiliated with another party that the latter would also be estopped? Another related to consideration: What if an assignor had received only a nominal amount of money for transferring the patent? But the question that most interested the Court was whether estoppel should operate differently if the assignment was not of a granted patent but of a patent application—as in fact was true in that case. The Court saw a possible distinction between the two. In a patent application, the Court began, the inventor "swor[e] to" a particular "specification." But the exact rights at issue were at that point "inchoate"—not "certainly defined." And afterward, the Court (presciently) observed, the claims might be "enlarge[d]" at "the instance of the assignee" beyond what the inventor had put forward. That might weaken the case for estoppel. But the Court decided not to decide the issue, given its holding that the assignor had not infringed the (narrowed) patent claim anyway.

III

Minerva's main argument here, as in the Federal Circuit, is that "assignor estoppel should be eliminated"—and indeed has been already. We reject that view. The doctrine has lasted for many years, and we continue to accept the fairness principle at its core. Minerva's back-up contention is that assignor estoppel "should be constrained." On that score, we find that the Federal Circuit has applied the doctrine too expansively. Today, we clarify the scope of assignor estoppel, including in the way *Westinghouse* suggested.

A

In its quest to abolish assignor estoppel, Minerva lodges three main arguments. The first two offer different reasons for why the doctrine is already defunct: because Congress repudiated it in the Patent Act of 1952 and because, even if not, this Court's post-*Westinghouse* cases leave no room for the doctrine to continue. The third, by contrast, is a present-day policy claim: that assignor estoppel "imposes" too high a "barrier to invalidity challenges" and so keeps bad patents alive.

[*Discussion of statutory interpretation of 1952 Patent Act omitted*]

We likewise do not accept Minerva's view that two of our post-*Westinghouse* decisions have already interred assignor estoppel. According to Minerva, *Scott Paper Co. v. Marcalus Mfg. Co.* "eliminated any justification for assignor estoppel and 'repudiated' the doctrine." And if that were not enough, Minerva continues, our decision in *Lear, Inc. v. Adkins*, 395 U. S. 653 (1969),[3] also "eviscerated any basis for assignor estoppel." But we think the words "eliminated," "repudiated," and "eviscerated" are far off. *Scott Paper* and *Lear* in fact retained assignor estoppel; all they did was police the doctrine's boundaries (just as *Westinghouse* did and we do today).

Whatever a worked-up dissent charged, *Scott Paper* did nothing more than decline to apply assignor estoppel in a novel and extreme circumstance. The petitioner in *Scott Paper* made the same ask Minerva does here: to abolish the *Westinghouse* rule. The Court expressly declined that request. And it restated the "basic principle" animating assignor

3 *Lear* is reproduced and discussed in Section 22.2.

estoppel, describing it as "one of good faith, that one who has sold his invention may not, to the detriment of the purchaser, deny the existence of that which he has sold." The Court, to be sure, declined to apply the doctrine in the case before it. There, estoppel would have prevented the assignor from making a device on which the patent had expired—a device, in other words, that had already entered the public domain. The Court could not find any precedent for applying estoppel in that situation. And the Court thought that doing so would carry the doctrine too far, reasoning that the public's interest in using an already-public invention outweighs the "interest in private good faith." But the Court did not question—again, it reaffirmed—the principle of fairness on which assignor estoppel rests in more common cases, where the assignee is not claiming to control a device unequivocally part of the public domain. In those cases, the doctrine remained intact.

Lear gives Minerva still less to work with. In that case, the Court considered and toppled a different patent estoppel doctrine. Called licensee estoppel, it barred (as its name suggests) a patent licensee from contesting the validity of the patent on a device he was paying to use. Minerva's basic claim is that as goes one patent estoppel rule, so goes another. But *Lear* did not purport to decide the fate of the separate assignor estoppel doctrine. To the contrary, the Court stated that the patent holder's "equities" in the assignment context "were far more compelling than those presented in the typical licensing arrangement." 395 U. S., at 664. And so they are.

In sum, *Scott Paper* and *Lear* left *Westinghouse* right about where they found it—as a bounded doctrine designed to prevent an inventor from first selling a patent and then contending that the thing sold is worthless. *Westinghouse* saw that about-face as unfair; *Scott Paper* and *Lear* never questioned that view. At the same time, *Westinghouse* realized that assignor estoppel has limits: Even in approving the doctrine, the Court made clear that not every assignor defense in every case would fall within its scope. *Scott Paper* and *Lear* adopted a similar stance. They maintained assignor estoppel, but suggested (if in different ways) that the doctrine needed to stay attached to its equitable moorings. The three decisions together thus show not the doctrinal "eviscerat[ion]" Minerva claims, but only the kind of doctrinal evolution typical of common-law rules.

Finally, we do not think, as Minerva claims, that contemporary patent policy—specifically, the need to weed out bad patents—supports overthrowing assignor estoppel. And we continue to think the core of assignor estoppel justified on the fairness grounds that courts applying the doctrine have always given. Assignor estoppel, like many estoppel rules, reflects a demand for consistency in dealing with others. When a person sells his patent rights, he makes an (at least) implicit representation to the buyer that the patent at issue is valid—that it will actually give the buyer his sought-for monopoly. In later raising an invalidity defense, the assignor disavows that implied warranty. And he does so in service of regaining access to the invention he has just sold. By saying one thing and then saying another, the assignor wants to profit doubly—by gaining both the price of assigning the patent and the continued right to use the invention it covers. That course of conduct by the assignor strikes us, as it has struck courts for many a year, as unfair dealing—enough to outweigh any loss to the public from leaving an invalidity defense to someone other than the assignor.

B

Still, our endorsement of assignor estoppel comes with limits—true to the doctrine's reason for being. Just as we guarded the doctrine's boundaries in the past, so too we do so today.

Assignor estoppel should apply only when its underlying principle of fair dealing comes into play. That principle, as explained above, demands consistency in representations about a patent's validity: What creates the unfairness is contradiction. When an assignor warrants that a patent is valid, his later denial of validity breaches norms of equitable dealing. And the original warranty need not be express; as we have explained, the assignment of specific patent claims carries with it an implied assurance. But when the assignor has made neither explicit nor implicit representations in conflict with an invalidity defense, then there is no unfairness in its assertion. And so there is no ground for applying assignor estoppel.

One example of non-contradiction is when the assignment occurs before an inventor can possibly make a warranty of validity as to specific patent claims. Consider a common employment arrangement. An employee assigns to his employer patent rights in any future inventions he develops during his employment; the employer then decides which, if any, of those inventions to patent. In that scenario, the assignment contains no representation that a patent is valid. How could it? The invention itself has not come into being. And so the employee's transfer of rights cannot estop him from alleging a patent's invalidity in later litigation.

A second example is when a later legal development renders irrelevant the warranty given at the time of assignment. Suppose an inventor conveys a patent for value, with the warranty of validity that act implies. But the governing law then changes, so that previously valid patents become invalid. The inventor may claim that the patent is invalid in light of that change in law without contradicting his earlier representation. What was valid before is invalid today, and no principle of consistency prevents the assignor from saying so.

Most relevant here, another post-assignment development—a change in patent claims—can remove the rationale for applying assignor estoppel. *Westinghouse* itself anticipated this point, which arises most often when an inventor assigns a patent application, rather than an issued patent. As *Westinghouse* noted, "the scope of the right conveyed in such an assignment" is "inchoate"—"less certainly defined than that of a granted patent." 266 U. S., at 352–353. That is because the assignee, once he is the owner of the application, may return to the PTO to "enlarge[]" the patent's claims. And the new claims resulting from that process may go beyond what "the assignor intended" to claim as patentable. *Westinghouse* did not need to resolve the effects of such a change, but its liberally dropped hints—and the equitable basis for assignor estoppel—point all in one direction. Assuming that the new claims are materially broader than the old claims, the assignor did not warrant to the new claims' validity. And if he made no such representation, then he can challenge the new claims in litigation: Because there is no inconsistency in his positions, there is no estoppel. The limits of the assignor's estoppel go only so far as, and not beyond, what he represented in assigning the patent application.

The Federal Circuit, in both its opinion below and prior decisions, has failed to recognize those boundaries. Minerva (recall, Truckai's alter-ego) argued to the court that estoppel should not apply because it was challenging a claim that was materially broader than the ones Truckai had assigned. But the court declined to consider that alleged disparity. Citing circuit precedent, the court held it "irrelevant" whether Hologic had expanded the assigned claims: Even if so, Minerva could not contest the new claim's validity. For the reasons given above, that conclusion is wrong. If Hologic's new claim is materially broader than the ones Truckai assigned, then Truckai could not have warranted its validity in making the assignment. And without such a prior inconsistent representation, there is no basis for estoppel.

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We remand this case to the Federal Circuit to now address what it thought irrelevant: whether Hologic's new claim is materially broader than the ones Truckai assigned. The parties vigorously disagree about that issue. In Truckai's view, the new claim expanded on the old by covering non-moisture-permeable applicator heads. In Hologic's view, the claim matched a prior one that Truckai had assigned. Resolution of that issue in light of all relevant evidence will determine whether Truckai's representations in making the assignment conflict with his later invalidity defense—and so will determine whether assignor estoppel applies.

IV

This Court recognized assignor estoppel a century ago, and we reaffirm that judgment today. But as the Court recognized from the beginning, the doctrine is not limitless. Its boundaries reflect its equitable basis: to prevent an assignor from warranting one thing and later alleging another. Assignor estoppel applies when an invalidity defense in an infringement suit conflicts with an explicit or implicit representation made in assigning patent rights. But absent that kind of inconsistency, an invalidity defense raises no concern of fair dealing—so assignor estoppel has no place.

For these reasons, we vacate the judgment of the Federal Circuit and remand the case for further proceedings consistent with this opinion.

It is so ordered.

Notes and Questions

1. *Contracting for estoppel*. In *Hologic*, Minerva (the assignor) argued that the doctrine of assignor estoppel should be abolished entirely. Among other things, it noted that "[a]n assignee who seeks protection against future competition from an assignor need simply negotiate a covenant not to compete in their agreement." How is a covenant not to compete different than assignor estoppel? Given these differences, how would you respond to Minerva's argument?
2. *Assignor estoppel in the modern workplace*. Prior to *Hologic*, Professor Mark Lemley argued that the assignor estoppel doctrine is largely unnecessary in today's economy.

> The nineteenth-century vision of assignor estoppel was directed at people who themselves sold a patent for profit. But modern assignor estoppel no longer is. Not only does it reach companies that never made such a promise, it extends to patents that did not exist at the time of the deal. More important, assignor estoppel is regularly applied to bind employee-inventors on the basis of their assignment of the patent to their employers. But nothing about the modern employee-inventor suggests that they are selling their inventions to their employers for profit. Employees are regularly required to assign all their inventions as a condition of employment. Those assignment agreements are standard-form contracts, usually presented to the employee on their first day of work, after they have quit their prior job and perhaps relocated. So they apply by definition to inventions that have not yet been made. Companies and universities impose them on all their employees, not just designated inventors; as a research assistant in law school, for instance, I was forced to assign all the inventions I might make during law school. And the employees are not normally paid extra in exchange for assigning their rights. Indeed, employees are sometimes compelled to disclose their inventions against their will so the employer can turn it into a patent. Even if they aren't, the signing of the inventor's

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> declaration is a relatively perfunctory act, done long after the employer himself has decided to pursue a patent. Employees may sign an inventorship form even if they doubt the validity of the invention because they fear to lose their job if they don't. And if the employee can't or won't sign the agreement, the law … allows the company to apply for a patent in their name without the employee's signature, simply by attesting that they were obligated to assign the invention.[4] Employees who assign their inventions have no ownership or financial interest in any patents that result. The employer holds legal title to the invention even if it was assigned before it was made.[5]

How does the Court in *Minerva* address Professor Lemley's arguments? Are you satisfied with its response?

22.2 LICENSEE ESTOPPEL

Just as the doctrine of assignor estoppel prevents the assignor of a patent from later challenging the validity of that patent, the related doctrine of licensee estoppel prohibits a patent licensee from challenging the validity of a licensed patent. Licensee estoppel has been described as "one of the oldest doctrines in the field of patent law."[6] The theory behind the doctrine is that a licensee should not be permitted to enjoy the benefits of a licensing agreement (i.e., protection from suit by the patentee) while simultaneously seeking to void the patent that forms the basis of the agreement. The Supreme Court upheld the doctrine in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 836 (1950),[7] but reversed its position and effectively abolished the doctrine in *Lear v. Adkins*, one of the most famous cases in patent law.

Lear, Inc. v. Adkins

395 U.S. 653 (1969)

HARLAN, JUSTICE

In January of 1953, John Adkins, an inventor and mechanical engineer, was hired by Lear Incorporated for the purpose of solving a vexing problem the company had encountered in its efforts to develop a gyroscope which would meet the increasingly demanding requirements of the aviation industry. The gyroscope is an essential component of the navigational system in all aircraft, enabling the pilot to learn the direction and altitude of his airplane. With the development of the faster airplanes of the 1950's, more accurate gyroscopes were needed, and the gyro industry consequently was casting about for new techniques which would satisfy this need in an economical fashion. Shortly after Adkins was hired, he developed a method of construction at the company's California facilities which improved gyroscope accuracy at a low cost. Lear almost immediately incorporated Adkins' improvements into its production process to its substantial advantage.

I

At the very beginning of the parties' relationship, Lear and Adkins entered into a rudimentary one-page agreement which provided that although "[a]ll new ideas, discoveries,

[4] 35 U.S.C. § 116 (2012).
[5] Mark A. Lemley, *Rethinking Assignor Estoppel*, 54 Houston L. Rev. 513, 516 (2016).
[6] *Lear, Inc. v. Adkins*, 67 Cal. 2d 882, 891, 435 P. 2d 321, 325–326 (1967).
[7] Discussed in the context of package licensing and patent misuse in Section 24.4.

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inventions etc. related [to] vertical gyros become the property of Mr. John S. Adkins," the inventor promised to grant Lear a license as to all ideas he might develop "on a mutually satisfactory royalty basis." As soon as Adkins' labors yielded tangible results it quickly became apparent to the inventor that further steps should be taken to place his rights to his ideas on a firmer basis. On February 4, 1954, Adkins filed an application with the Patent Office in an effort to gain federal protection for his improvements. At about the same time, he entered into a lengthy period of negotiations with Lear in an effort to conclude a licensing agreement which would clearly establish the amount of royalties that would be paid.

These negotiations finally bore fruit on September 15, 1955, when the parties approved a complex 17-page contract which carefully delineated the conditions upon which Lear promised to pay royalties for Adkins' improvements. The parties agreed that "if the United States Patent Office refuses to issue a patent on the substantial claims [contained in Adkins' original patent application] or if such a patent so issued is subsequently held invalid then in any of such events Lear at its option shall have the right forthwith to terminate the specific license so affected or to terminate this entire Agreement …"

As the contractual language indicates, Adkins had not obtained a final Patent Office decision as to the patentability of his invention at the time the licensing agreement was concluded. Indeed, he was not to receive a patent until January 5, 1960.

The progress of Adkins' effort to obtain a patent followed the typical pattern. In his initial application, the inventor made the ambitious claim that his entire method of constructing gyroscopes was sufficiently novel to merit protection. The Patent Office, however, rejected this initial claim, as well as two subsequent amendments, which progressively narrowed the scope of the invention sought to be protected. Finally, Adkins narrowed his claim drastically to assert only that the design of the apparatus used to achieve gyroscope accuracy was novel. In response, the Office issued its 1960 patent, granting a 17-year monopoly on this more modest claim.

During the long period in which Adkins was attempting to convince the Patent Office of the novelty of his ideas, however, Lear had become convinced that Adkins would never receive a patent on his invention and that it should not continue to pay substantial royalties on ideas which had not contributed substantially to the development of the art of gyroscopy. In 1957, after Adkins' patent application had been rejected twice, Lear announced that it had searched the Patent Office's files and had found a patent which it believed had fully anticipated Adkins' discovery. As a result, the company stated that it would no longer pay royalties on the large number of gyroscopes it was producing at its plant in Grand Rapids, Michigan (the Michigan gyros). Payments were continued on the smaller number of gyros produced at the company's California plant for two more years until they too were terminated on April 8, 1959 (the California gyros).

As soon as Adkins obtained his patent in 1960, he brought this lawsuit in the California Superior Court. He argued to a jury that both the Michigan and the California gyros incorporated his patented apparatus and that Lear's failure to pay royalties on these gyros was a breach both of the 1955 contract and of Lear's quasi-contractual obligations. Although Lear sought to raise patent invalidity as a defense, the trial judge directed a verdict of $16,351.93 for Adkins on the California gyros, holding that Lear was estopped by its licensing agreement from questioning the inventor's patent. The trial judge took a different approach when it came to considering the Michigan gyros. Noting that the Company claimed that it had developed its Michigan designs independently of Adkins' ideas, the court instructed the jury to award the inventor recovery only if it was satisfied that Adkins' invention was novel, within the meaning of the federal patent laws. When the jury returned a verdict for Adkins of $888,122.56 on the Michigan gyros, the trial judge granted Lear's motion for judgment notwithstanding the verdict, finding that Adkins' invention had been completely anticipated by the prior art.

Once again both sides appealed, this time to the California Supreme Court, which took yet another approach to the problem presented. The court rejected the Court of Appeals' conclusion that the 1955 license gave Lear the right to terminate its royalty obligations in 1959. Since the 1955 agreement was still in effect, the court concluded, relying on the language we have already quoted, that the doctrine of estoppel barred Lear from questioning the propriety of the Patent Office's grant. The court's adherence to estoppel, however, was not without qualification. After noting Lear's claim that it had developed its Michigan gyros independently, the court tested this contention by considering "whether what is being built by Lear [in Michigan] springs entirely" (emphasis supplied) from the prior art. Applying this test, it found that Lear had in fact "utilized the apparatus patented by Adkins throughout the period in question," reinstating the jury's $888,000 verdict on this branch of the case.

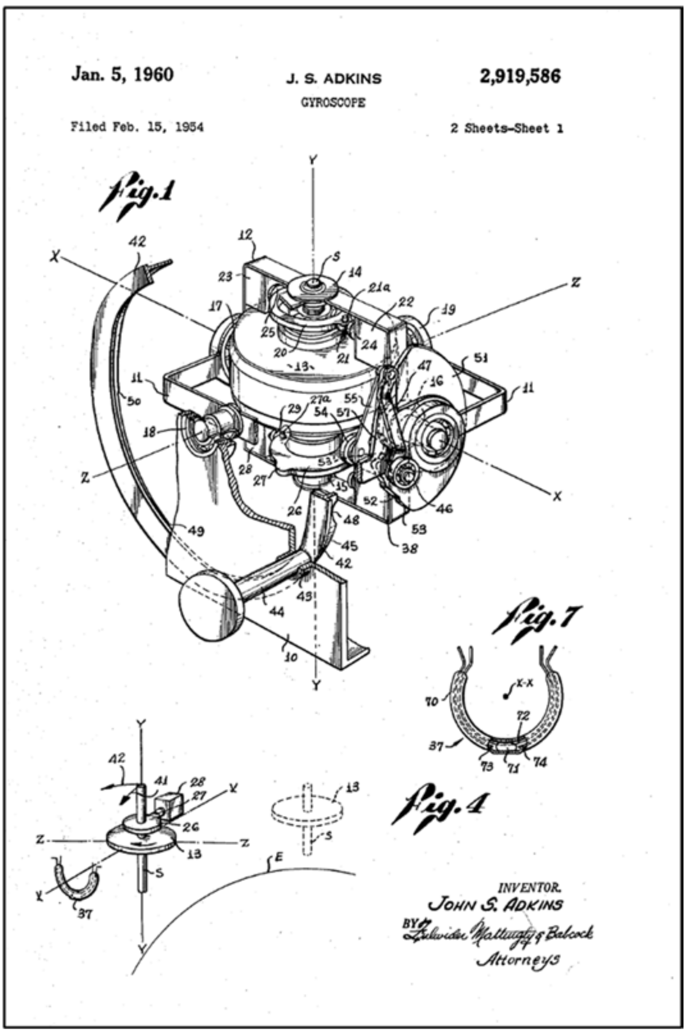

FIGURE 22.1 The gyroscope invention in *Lear v. Adkins*.

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II

Since the California Supreme Court's construction of the 1955 licensing agreement is solely a matter of state law, the only issue open to us is raised by the court's reliance upon the doctrine of estoppel to bar Lear from proving that Adkins' ideas were dedicated to the common welfare by federal law. In considering the propriety of the State Court's decision, we are well aware that we are not writing upon a clean slate. The doctrine of estoppel has been considered by this Court in a line of cases reaching back into the middle of the 19th century. Before deciding what the role of estoppel should be in the present case and in the future, it is, then, desirable to consider the role it has played in the past.

A

While the roots of the doctrine have often been celebrated in tradition, we have found only one 19th century case in this Court that invoked estoppel in a considered manner. And that case was decided before the Sherman Act made it clear that the grant of monopoly power to a patent owner constituted a limited exception to the general federal policy favoring free competition. *Kinsman v. Parkhurst*, 18 How. 289 (1855).

In [1892], this Court found the doctrine of patent estoppel so inequitable that it refused to grant an injunction to enforce a licensee's promise never to contest the validity of the underlying patent. "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 …" *Pope Manufacturing Co. v. Gormully*, 144 U.S. 224, 234 (1892).

Although this Court invoked an estoppel in 1905 without citing or considering *Pope's* powerful argument, the doctrine was not to be applied again in this Court until it was revived in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*, which declared, without prolonged analysis, that licensee estoppel was "the general rule." In so holding, the majority ignored the teachings of a series of decisions this Court had rendered during the 45 years since [*United States v. Harvey Steel Co.*, 196 U.S. 310 (1905)] had been decided. During this period, each time a patentee sought to rely upon his estoppel privilege before this Court, the majority created a new exception to permit judicial scrutiny into the validity of the Patent Office's grant. Long before *Hazeltine* was decided, the estoppel doctrine had been so eroded that it could no longer be considered the "general rule," but was only to be invoked in an ever-narrowing set of circumstances.

B

The estoppel rule was first stringently limited in a situation in which the patentee's equities were far more compelling than those presented in the typical licensing arrangement. *Westinghouse Electric & Manufacturing Co. v. Formica Insulation Co.*, 266 U.S. 342 (1924), framed a rule to govern the recurring problem which arises when the original patent owner, after assigning his patent to another for a substantial sum, claims that the patent is worthless because it contains no new ideas. The courts of appeals had traditionally refused to permit such a defense to an infringement action on the ground that it was improper both "to sell and keep the same thing." Nevertheless, *Formica* imposed a limitation upon estoppel which was radically inconsistent with the premises upon which the "general rule" is based. The Court held that while an assignor may not directly attack the validity of a patent by reference to the prior state of the art, he could introduce such evidence to narrow the claims made in the patent. "The distinction seems a nice one but seems to be workable."

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Workable or not, the result proved to be an anomaly: if a patent had some novelty *Formica* permitted the old owner to defend an infringement action by showing that the invention's novel aspects did not extend to include the old owner's products; on the other hand, if a patent had no novelty at all, the old owner could not defend successfully since he would be obliged to launch the direct attack on the patent that Formica seemed to forbid. The incongruity of this position compelled at least one court of appeals to carry the logic of the Formica exception to its logical conclusion. In 1940 the Seventh Circuit held that a licensee could introduce evidence of the prior art to show that the licensor's claims were not novel at all and thus successfully defend an action for royalties.

In *Scott Paper Co. v. Marcalus Manufacturing Co.*, 326 U.S. 249 (1945), this Court adopted a position similar to the Seventh Circuit's, undermining the basis of patent estoppel even more than [*Westinghouse*] had done. In *Scott*, the original patent owner had attempted to defend an infringement suit brought by his assignee by proving that his product was a copy of an expired patent. The Court refused to permit the assignee to invoke an estoppel, finding that the policy of the patent laws would be frustrated if a manufacturer was required to pay for the use of information which, under the patent statutes, was the property of all. Chief Justice Stone, for the Court, did not go beyond the precise question presented by a manufacturer who asserted that he was simply copying an expired patent. Nevertheless it was impossible to limit the *Scott* doctrine to such a narrow compass. If patent policy forbids estoppel when the old owner attempts to show that he did no more than copy an expired patent, why should not the old owner be also permitted to show that the invention lacked novelty because it could be found in a technical journal or because it was obvious to one knowledgeable in the art? The *Scott* exception had undermined the very basis of the "general rule."

III

> *"federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent"*

The uncertain status of licensee estoppel in the case law is a product of judicial efforts to accommodate the competing demands of the common law of contracts and the federal law of patents. On the one hand, the law of contracts forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made. On the other hand, federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent. When faced with this basic conflict in policy, both this Court and courts throughout the land have naturally sought to develop an intermediate position which somehow would remain responsive to the radically different concerns of the two different worlds of contract and patent. The result has been a failure. Rather than creative compromise, there has been a chaos of conflicting case law, proceeding on inconsistent premises. Before renewing the search for an elusive middle ground, we must reconsider on their own merits the arguments which may properly be advanced on both sides of the estoppel question.

A

It will simplify matters greatly if we first consider the most typical situation in which patent licenses are negotiated. In contrast to the present case, most manufacturers obtain a license

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after a patent has issued. Since the Patent Office makes an inventor's ideas public when it issues its grant of a limited monopoly, a potential licensee has access to the inventor's ideas even if he does not enter into an agreement with the patent owner. Consequently, a manufacturer gains only two benefits if he chooses to enter a licensing agreement after the patent has issued. First, by accepting a license and paying royalties for a time, the licensee may have avoided the necessity of defending an expensive infringement action during the period when he may be least able to afford one. Second, the existence of an unchallenged patent may deter others from attempting to compete with the licensee.

Under ordinary contract principles the mere fact that some benefit is received is enough to require the enforcement of the contract, regardless of the validity of the underlying patent. Nevertheless, if one tests this result by the standard of good-faith commercial dealing, it seems far from satisfactory. For the simple contract approach entirely ignores the position of the licensor who is seeking to invoke the court's assistance on his behalf. Consider, for example, the equities of the licensor who has obtained his patent through a fraud on the Patent Office. It is difficult to perceive why good faith requires that courts should permit him to recover royalties despite his licensee's attempts to show that the patent is invalid.

Even in the more typical cases, not involving conscious wrongdoing, the licensor's equities are far from compelling. A patent, in the last analysis, simply represents a legal conclusion reached by the Patent Office. Moreover, the legal conclusion is predicated on factors as to which reasonable men can differ widely. Yet the Patent Office is often obliged to reach its decision in an ex parte proceeding, without the aid of the arguments which could be advanced by parties interested in proving patent invalidity. Consequently, it does not seem to us to be unfair to require a patentee to defend the Patent Office's judgment when his licensee places the question in issue, especially since the licensor's case is buttressed by the presumption of validity which attaches to his patent. Thus, although licensee estoppel may be consistent with the letter of contractual doctrine, we cannot say that it is compelled by the spirit of contract law, which seeks to balance the claims of promisor and promisee in accord with the requirements of good faith.

Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. We think it plain that the technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued.

We are satisfied that *Automatic Radio Co. v. Hazeltine Research, Inc.*, itself the product of a clouded history, should no longer be regarded as sound law in respect of its "estoppel" holding, and that holding is now overruled.

> *"Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification."*

B

The terms of the 1955 agreement provide that royalties are to be paid until such time as "the patent is held invalid," and the fact remains that the question of patent validity has not been finally determined in this case. Thus, it may be suggested that although Lear must be allowed to raise the question of patent validity in the present lawsuit, it must also be required to comply with its contract and continue to pay royalties until its claim is finally vindicated in the courts.

The parties' contract, however, is no more controlling on this issue than is the State's doctrine of estoppel, which is also rooted in contract principles. The decisive question is whether overriding federal policies would be significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging patent validity in the courts.

It seems to us that such a requirement would be inconsistent with the aims of federal patent policy. Enforcing this contractual provision would give the licensor an additional economic incentive to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning. We can perceive no reason to encourage dilatory court tactics in this way. Moreover, the cost of prosecuting slow-moving trial proceedings and defending an inevitable appeal might well deter many licensees from attempting to prove patent invalidity in the courts. The deterrence effect would be particularly severe in the many scientific fields in which invention is proceeding at a rapid rate. In these areas, a patent may well become obsolete long before its 17-year term has expired. If a licensee has reason to believe that he will replace a patented idea with a new one in the near future, he will have little incentive to initiate lengthy court proceedings, unless he is freed from liability at least from the time he refuses to pay the contractual royalties. Lastly, enforcing this contractual provision would undermine the strong federal policy favoring the full and free use of ideas in the public domain. For all these reasons, we hold that Lear must be permitted to avoid the payment of all royalties accruing after Adkins' 1960 patent issued if Lear can prove patent invalidity.

The judgment of the Supreme Court of California is vacated and the case is remanded to that court for further proceedings not inconsistent with this opinion.

Notes and Questions

1. *State versus federal*. Why was *Lear* appealed to the US Supreme Court from the California Supreme Court, rather than from a federal appellate court? Why do you think that Adkins brought his suit in state rather than federal court?
2. *Patent policy*. Justice Harlan bases the holding in *Lear* in large part on the existence of a federal policy that favors the invalidation of improperly issued patents. What is the justification for such a policy, and from what legal source does it derive?
3. *Balance of the equities*. In weighing the value of the licensee estoppel doctrine, the *Lear* Court says that "the licensor's equities are far from compelling," even in the face of the presumption of validity of patents issued by the PTO. Why?
4. *Economic incentives*. Why is it likely that "Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery"? Should this matter? What about the licensor's economic position?

5. *Why not assignor estoppel*? Why does the Court in *Lear* distinguish between licensee and assignor estoppel? Why does it permit assignor estoppel to survive when it abolishes licensee estoppel?
6. *Contract doctrine*. What does Justice Harlan mean in *Lear* when he writes, "although licensee estoppel may be consistent with the letter of contractual doctrine, we cannot say that it is compelled by the spirit of contract law"? What "spirit" of contract law is he referring to, and why does it militate against the licensee estoppel doctrine?
7. *Termination*. The agreement in *Lear* states: "if the [PTO] refuses to issue a patent on the substantial claims … Or if such patent so issued is subsequently held invalid then … Lear at its option shall have the right forthwith to *terminate* the specific license so affected or to *terminate* this entire Agreement …" (emphasis added). Why would Lear wish to terminate its license? Did it actually exercise its right of termination? Why or why not?
8. *Pre-issuance royalties*. The Court in *Lear* avoids the question of whether Lear must pay Adkins royalties for the period from when the licensing agreement was signed in 1955 until the patent issued in 1960. This, the Court concedes, is a question of state contract law, as no patent right yet exists: "it squarely raises the question whether, and to what extent, the States may protect the owners of unpatented inventions who are willing to disclose their ideas to manufacturers only upon payment of royalties." How would you answer this question? As it turns out, the Court did answer this question ten years later in *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) (discussed and reproduced in Section 24.3.2).
9. *Benefit of the bargain?* In Part III.B of *Lear*, Justice Harlan acknowledges that under the licensing agreement royalties are to be paid until such time as "the patent is held invalid." He also notes that, at the time of writing, the patent had not yet been held invalid. Given that the patent issued in 1960 and the Court's decision was rendered in 1969, it would likely be 1970 or later before Adkins' patent was finally determined to be invalid (cutting approximately seven years from its full duration). According to the express language of the licensing agreement, if the patent were found to be invalid, Lear was required to pay royalties for the period through the invalidity finding (i.e., 1960 through 1970 [assuming that is when invalidity was found]). But the Court says that if the patent is eventually found invalid, Lear should be relieved of the payment of any future royalties from *the date of the patent's issuance* (1960). The difference is ten full years of royalties – a significant amount. Why doesn't the Court hold Lear to its contractual bargain?
10. *Is Lear still needed?* Some commentators have observed that when *Lear* was decided in 1969, a patent licensee was the party most likely to challenge the validity of a patent. However, in the intervening years, it has become much easier and much less expensive to challenge the validity of patents before they are licensed, including at the Patent Trial and Appeals Board (PTAB). Given the increased ease with which patent validity may be challenged today, is there less justification for eliminating the licensee estoppel doctrine? See Rob Merges, Patents, *Validity Challenges, and Private Ordering: A New Dispensation for the Easy-Challenge Era* (working paper, Dec. 2021)
11. *License eviction*. Prior to *Lear*, the doctrine of licensee estoppel held that a licensee was not permitted to dispute the validity of a licensed patent in order to avoid paying royalties. Yet an exception was recognized when the patent was invalidated in a separate proceeding not brought by the licensee. If that occurred, the licensee was said to be "evicted" from the license. As the court explained in *Drackett Chem. Co. v. Chamberlain Co.*, 63 F.2d 853, 854 (6th Cir. 1933):

> The subject-matter of such a contract is essentially the monopoly which the grant confers: the right of property which it creates, and, when this monopoly has been destroyed, and the

exclusive rights of manufacture, sale, and use, purported to have been created by the patent, are judicially decreed to be no longer exclusive, but are thrown open to the public at large, there has been a complete failure of consideration – an eviction – which should justify a termination of the contract. Prior to such eviction, the mere invalidity of the patent is properly held not to be a sufficient defense, because the licensee may still continue to enjoy all the benefits of a valid patent. It may be respected, and the licensee would then have just what he bargained for … It is only when, by judicial decree or otherwise, it is published to the world that the monopoly is destroyed, that the licensee can claim a corresponding release from his obligation to pay royalties.

Did the doctrine of eviction ameliorate the policy effects of the licensee estoppel doctrine? What perverse results might this doctrine have created?

FIGURE 22.2 The Drackett Chemical Company of Cincinnati, Ohio, created many household cleaning products that are still in use, including Windex, Dawn and Drāno.

12. *Restitution of paid royalties*. The Court in *Lear* holds that "Lear must be permitted to avoid the payment of all royalties accruing after Adkins' 1960 patent issued if Lear can prove patent invalidity." But Lear stopped paying royalties in 1957, when it believed that it found prior art that would invalidate Adkins' patent. So if the patent were found invalid in 1970 (using our hypothetical from Note 9), Lear would have no obligation to pay royalties to Adkins for the period from 1960 to 1970. But what if Lear, like a good licensee, *had* paid royalties to Adkins for part of that period (say from 1960 to 1965) before realizing that the patent was likely invalid and ceasing its royalty payments? When the patent was finally invalidated in 1970, would Lear receive a refund of the royalties it paid during the five-year period that it thought the patent was valid? Under the doctrine of "license eviction," the answer is generally no.

In *Drackett*, 63 F.2d at 855, the licensee had paid royalties under a licensing agreement for some years before the licensed patent was invalidated in a different proceeding. Once the licensee was thus "evicted" from its license (see Note 10), it had no further obligation to pay royalties under the licensing agreement. However, the court also held that "there was no such mistake of fact (the validity of the patents) as would warrant a recovery of royalties

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already paid" – implying that only the contractual doctrines of mistake of fact or, perhaps, fraud in the inducement might give rise to a claim for recovery of paid royalties.

The Sixth Circuit revisited the eviction doctrine in *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 465 F.2d 1253 (6th Cir. 1972) to determine whether *Drackett* had been overturned by *Lear*. That is, whether *Lear* implies that an invalid patent is invalidated *ab initio* – from the moment it was issued – thus giving the licensee a claim for restitution of all royalties previously paid. In an opinion that continues to be cited today, the Sixth Circuit held not:

> A rule that licensees can recover all royalties paid on a patent which later is held to be invalid would do far more than "unmuzzle" licensees. It would give the licensee the advantage of a "heads-I-win, tails-you-lose" option. *Lear* states that it is in the public interest to encourage an early adjudication of invalidity of patents. Application of the holding of the District Court could defeat early adjudication of invalidity and encourage tardy and marginal litigation. If the licensee could recover royalties paid (subject to any statute of limitations) on the basis of an adjudication of invalidity accomplished by another litigant, without incurring

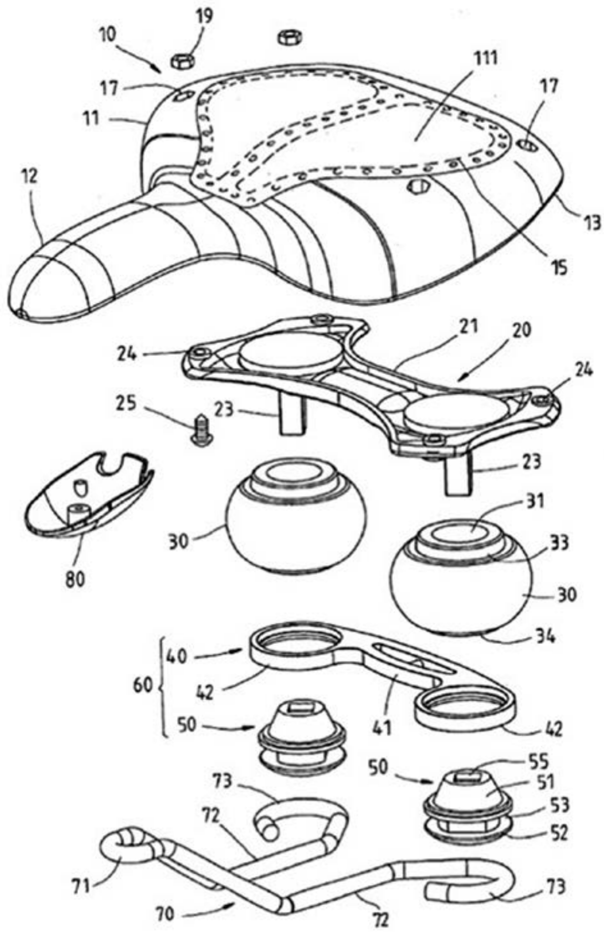

FIGURE 22.3 In *Troxel v. Schwinn*, Schwinn held a design patent for a bicycle seat issued in 1966. After Schwinn accused Troxel of infringement, Troxel took a license in 1967. Later that year, Troxel notified Schwinn that Goodyear was also selling infringing bicycle seats. Schwinn sued Goodyear, and the patent was found to be invalid in 1969. Troxel then sued to recover royalties previously paid to Schwinn under its licensing agreement.

> the expense or trouble of litigation, there would be less inducement for him to challenge the patent and thus remove an invalid patent from the competitive scene. He would be more likely to wait for somebody else to battle the issue because he would have nothing to lose by the delay.
>
> Rather than stimulating early litigation to test patent validity, such an interpretation of *Lear* would make it advantageous for a licensee to postpone litigation, enjoy the fruits of his licensing agreement, and sue for repayment of royalties near the end of the term of the patent. When a licensed patent is about to expire and the threat of injunction no longer exists, a licensee would have little to lose in bringing an action to recover all the money he has paid in royalties on the ground of the invalidity of the patent. The licensee would have a chance to regain all the royalties paid while never having been subjected to the risk of an injunction. Such an interpretation of *Lear* would defeat one of the expressed purposes of the court in announcing that decision.

Do you agree with the court's reasoning? Does the result in *Troxel* diminish the force of *Lear*? What arguments might be made that a licensee *should* be entitled to recoup paid royalties after a licensed patent is found to be invalid?

22.3 VALIDITY CHALLENGES UNDER THE DECLARATORY JUDGMENT ACT

In the assignee estoppel cases discussed in Section 22.1, the assignee of a patent was sued for infringement, then raised the invalidity of the asserted patent as a defense. The patentee, in turn, argued that the assignee was estopped from raising the invalidity defense. After *Lear*, a licensee that believed that a licensed patent was invalid could stop paying royalties and then assert invalidity when the patentee sued it for breach of contract and, after the licensor terminated the licensing agreement for breach, patent infringement.

Though the Supreme Court in *Lear* sought to "unmuzzle" licensees and enable them to challenge potentially invalid patents, the pathway cleared by *Lear* was, in reality, a difficult one for licensees. That is, if the licensee wishes to stop paying royalties on a questionable patent, it must intentionally breach the licensing agreement and wait to be sued for nonpayment and infringement before asserting its claim of invalidity. And, of course, there is always a chance (sometimes a large one) that the invalidity defense will fail and the patent will be upheld, in which case the licensee will be no more than a willful infringer. Thus, in order to take advantage of the freedom to challenge afforded by *Lear*, the licensee must take a substantial risk.

There is, of course, another option. As discussed in Section 5.1, the Declaratory Judgment Act, 28 U.S.C. § 2201, provides that "In a case of actual controversy … any court of the United States … may declare the rights and other legal relations of any interested party seeking such a declaration." And, as cases such as *SanDisk v. STMicroelectronics* demonstrate (see Section 5.1), such declaratory judgment actions may be brought to establish the validity of a patent before it is asserted in litigation. Thus, there is a route for parties to challenge the validity of patents in court before they are sued by the patent holder.

There is, however, a catch. The Declaratory Judgment Act requires that in order for a court to hear a declaratory judgment action, there must be "a case of actual controversy." In Section 5.1 we discussed situations in which a patent holder approaches an alleged infringer, and what degree of "threat" is necessary to give rise to an "actual controversy." Though the standard has varied over the years, an unlicensed party that may be infringing a patent can often make out a case for declaratory judgment after being "approached" by a patent holder with a licensing offer.

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But when one is actually *licensed* under the patent, where is the threat? Unlike an alleged infringer, a licensee in good standing is not threatened by the patent holder. Does this fact prevent licensees from challenging licensed patents under the Declaratory Judgment Act? In *Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376 (Fed. Cir. 2004), the Federal Circuit held that under the Declaratory Judgment Act, no case or controversy exists while a license remains in force. To challenge a licensed patent, the licensee must stop paying royalties and breach the licensing agreement. This breach creates a case or controversy, which gives the licensee jurisdiction under the Act. However, it also places the licensee in a difficult spot: It is in breach of the contract, it could be subject to contractual damages, it risks treble damages for willful infringement as well as the loss of its right to operate its business if the patent is ultimately found to be valid, and it also loses any other benefits that it enjoyed under the terminated licensing agreement (e.g., licenses under *other* patents or IP rights not being challenged). Nevertheless, Judge Rader, writing for the court, explained that:

> [P]ermitting Gen-Probe to pursue a lawsuit without materially breaching its license agreement yields undesirable results. Vysis voluntarily relinquished its statutory right to exclude by granting Gen-Probe a nonexclusive license. In so doing, Vysis chose to avoid litigation as an avenue of enforcing its rights. Allowing this action to proceed would effectively defeat those contractual covenants and discourage patentees from granting licenses. In other words, in this situation, the licensor would bear all the risk, while licensee would benefit from the license's effective cap on damages or royalties in the event its challenge to the patent's scope or validity fails.
>
> Under these circumstances, there is not a reasonable apprehension of suit. Therefore, this court holds that no actual controversy supports jurisdiction under the Declaratory Judgment Act for Gen-Probe's suit against Vysis over the … patent.

This result, harsh as it was for licensees, remained in force for only three years. In 2007, the Supreme Court overturned *Gen-Probe* in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007). In 1997, MedImmune entered into a licensing agreement with Genentech for multiple patents and patent applications. In 2001, one of the patent applications matured into an issued patent and Genentech notified MedImmune that royalties were due with respect to MedImmune's respiratory drug Synagis. MedImmune believed that the patent, as issued, was invalid. In response, it did two things. First, to avoid breaching the agreement, it paid the royalties demanded by Genentech (albeit under protest). Second, it brought an action in district court seeking a declaration of the patent's invalidity. Citing *Gen-Probe*, the district court dismissed MedImmune's claim, and the Federal Circuit affirmed. In an opinion written by Justice Scalia, the Supreme Court reversed.

First, the Court recognized that MedImmune considered Genentech's royalty demand letter "to be a clear threat to enforce the … patent, terminate the 1997 license agreement, and sue for patent infringement if [MedImmune] did not make royalty payments as demanded." In considering whether MedImmune was required to cease making royalty payments in order to avail itself of the Declaratory Judgment Act, Justice Scalia analogized the situation to one in which a petitioner is permitted to challenge the Constitutionality of a law without actually violating the law, or to ask a court to opine on the legality of demolishing a building before "drop[ping] the wrecking ball." In these examples, it is reasonable for a court to recognize the existence of a "controversy" without the need for the plaintiff to inflict substantial self-injury upon itself. Likewise, the Court held that MedImmune "was not required, insofar as Article III is concerned, to break or terminate its 1997 license agreement before seeking a declaratory judgment in federal court that the underlying patent is invalid, unenforceable, or not infringed."

In ruling for MedImmune, the Court quoted the standard for declaratory judgment relief articulated in *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273 (1941):

> Whether the facts alleged, under all circumstances, show that there is a substantial controversy between parties having adverse legal interests of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.

In doing so, it eliminated any requirement that a licensee breach its licensing agreement in order to challenge the validity of licensed patents.

Notes and Questions

1. MedImmune *and* Lear. At the Federal Circuit, MedImmune argued that "under *Lear v. Adkins*, it has the absolute right to challenge the validity or enforceability of the patent, whether or not it breaches the license and whether or not it can be sued by the patentee." The Federal Circuit, relying on *Gen-Probe*, rejected this argument. But the Supreme Court hardly mentioned *Lear* in its opinion. Why not? Does the ruling in *MedImmune* support or contradict the policy considerations raised in *Lear*?
2. *Incentives*. The Court's decision in *MedImmune* makes it easier for a licensee to challenge the validity of a licensed patent. What types of conduct might this decision encourage?
3. *What is a threat*? In *MedImmune*, as in many biopharma licensing disputes, a single Genentech patent was at issue. MedImmune successfully argued that its failure to pay royalties with respect to that patent would expose it to an infringement suit by Genentech – a threat sufficient to confer standing on MedImmune to challenge the patent in a declaratory judgment action. In contrast, in *Apple Inc. v. Qualcomm Inc.*, 992 F.3d 1378 (Fed. Cir. 2021), Apple and Qualcomm settled global patent litigation with an agreement under which Qualcomm granted Apple a six-year royalty-bearing license to tens of thousands of patents. After this, Apple continued to prosecute invalidity challenges against two Qualcomm patents at the Patent Trial and Appeals Board (PTAB); these challenges were appealed to the Federal Circuit. The Federal Circuit held that Apple lacked standing to maintain its suit.[8] First, it reasoned that the invalidity of the two patents, even if proven, would not affect Apple's royalty obligation under the global licensing agreement.[9] Second, Apple provided no evidence that it would manufacture a product that infringed the patents after the expiration of the licensing agreement. Finally, Apple's contention that Qualcomm had exhibited a pattern of suing licensees, including Apple, after licensing agreements expired was too speculative to confer standing on Apple. Do you agree? Under what circumstances, if any, should Apple be permitted to challenge patents within the large portfolio licensed by Qualcomm? Is there a public interest arising under *Lear* in allowing such challenges?
4. *Declaratory Judgment Jurisdiction*. In *Red Wing Shoe Co. v. Hockerson-Halberstadt, Inc.*, 148 F.3d 1355 (Fed. Cir. 1998), HHI, a Louisiana-based patent assertion entity (PAE), sent Red Wing a demand letter and invitation to license. HHI then entered into correspondence

[8] The Federal Circuit's holding did not limit Apple's ability to challenge Qualcomm's patents at the PTAB. It observed that "nearly any person" may initiate such an administrative challenge, with no requirement of constitutional standing.

[9] As discussed in Section 24.4, parties are permitted to bundle together multiple patents at a single royalty rate, without adjusting the rate each time an individual patent expires, so long as the arrangement is for the mutual convenience of the parties.

with Red Wing, in which HHI granted Red Wing an extension of time and then rebutted Red Wing's contentions of noninfringement. At that point, Red Wing brought a declaratory judgment action against HHI in its home jurisdiction of Minnesota. HHI moved to dismiss based on a lack of personal jurisdiction. Red Wing argued that the three letters sent by HHI to Red Wing at its Minnesota location "not only sought to inform Red Wing of potential infringement but also solicited business with Red Wing in Minnesota." The district court determined that it lacked personal jurisdiction over HHI and the Federal Circuit affirmed. In *Trimble Inc. v. Perdiemco LLC*, 997 F.3d 1147 (Fed. Cir. 2021), the plaintiff PAE exchanged a total of twenty-two communications with the defendant over a period of three months. This, the court ruled, "easily satisfied" the personal jurisdiction requirement in a declaratory judgment action brought by the defendant in its home jurisdiction. The court specifically held that *Red Wing* did not compel a finding in the plaintiff's favor on the facts of this case. Given these two data points (three versus twenty-two communications), just how much correspondence must a patent holder have with a potential licensee before being subject to the jurisdiction of the defendant's home court? To what extent do these cases encourage patent holders to adopt a "sue first, talk later" strategy?

22.4 NO-CHALLENGE CLAUSES

22.4.1 *Agreements Not to Challenge*

Lear eliminated the estoppel doctrine that prevented licensees from challenging the validity of licensed patents, and *MedImmune* opened the way for licensees to challenge validity through declaratory judgment actions without having to breach their licensing agreements. With these new avenues open for challenges to the validity of licensed patents, it is not surprising that transactional practices quickly adapted to prohibit such challenges through so-called "no-challenge" or "no-contest" clauses. Below is an example of such a clause.

EXAMPLE: NO-CHALLENGE

a. Licensee agrees that it shall not, at any time in the future, directly or indirectly aid, assist or participate in any action contesting or seeking to limit the validity, scope or enforceability of any Licensed Patent in any court, review board or tribunal or before any patent office or administration anywhere in the world, or knowingly disclose to any third party or to the public any document, record, prior art or other information that could have the effect of assisting in any current or future action contesting the validity, scope or enforceability of any Licensed Patent, except as may be required by law or order of any court of competent jurisdiction.
b. Licensee expressly waives any and all invalidity and unenforceability defenses that it may have in any future litigation, arbitration or proceeding relating to the Licensed Patents.

As you can see, the above example prohibits the licensee both from affirmatively challenging the validity of any licensed patent (both in court and at the PTO) and from asserting any invalidity defense in any future proceeding with licensor.

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Not surprisingly, the rise of no-challenge clauses soon led to litigation over their enforceability in a range of contexts. *Lear* remains strong precedent, and its general encouragement of validity challenges has prevented the widespread adoption of no-challenge clauses. Yet these clauses appear in a widening group of licensing agreements, as discussed in *Flex-Foot*.

Flex-Foot, Inc. v. CRP, Inc.

238 F.3d 1362 (Fed. Cir. 2001)

LINN, CIRCUIT JUDGE

Background

This is the third litigation between [CRP, Inc. d/b/a Springlite ("Springlite")] and [Flex-Foot, Inc. and Van L. Phillips (collectively "Flex-Foot")] regarding U.S. Patent No. 4,822,363 (the " '363 patent"). In 1989, Flex-Foot brought the first lawsuit against Springlite for infringement of the '363 patent. That action was promptly settled and dismissed by way of a settlement agreement and a corresponding license agreement in which Springlite agreed to pay a royalty on the accused Springlite device.

Springlite contends that its primary motivation in settling with Flex-Foot at that time was economic. Springlite did not have the financial resources to defend against Flex-Foot's infringement claims. Neither the settlement agreement nor the license agreement acknowledged that Springlite's device infringed the '363 patent. In addition, neither agreement barred Springlite from later challenging the validity of the '363 patent. In fact, the license expressly provided that it would expire upon judicial determination that the '363 patent was invalid.

Springlite brought a second action in 1993 (the "DJ action"), seeking a declaration that the '363 patent was invalid. The parties thereafter conducted discovery and fully briefed a motion for summary judgment regarding Springlite's invalidity allegations. While that motion was pending, however, the parties settled the case in March 1994 via another settlement agreement (the "March 1994 Settlement Agreement") and corresponding license agreement (the "March 1994 License Agreement").

The March 1994 Settlement Agreement contains language making it clear that Springlite waived its right to challenge the validity and enforceability of the '363 patent. Specifically, paragraph 7.1 states:

> 7.1 The CRP Group agrees not to challenge or cause to be challenged, directly or indirectly, the validity or enforceability of the '913 patent and/or the '363 patent in any court or other tribunal, including the United States Patent and Trademark Office. As to the '363 and '913 patents only, the CRP Group waives any and all invalidity and unenforceability defenses in any future litigation, arbitration, or other proceeding.

In addition, paragraph 6 of the March 1994 License Agreement states:

> CRP agrees not to challenge or cause to be challenged, directly or indirectly, the validity or unenforceability, or scope of the '913 patent and/or the '363 patent in any court or tribunal, or before the United States Patent and Trademark Office or in any arbitration proceeding. This waiver is expressly limited to challenges to the '363 and '913 patents, but applies without exception to any and all products which CRP may make, use or sell in the

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future. CRP also waives any argument that the licensed products are not covered by one or more claims of the '913 or '363 patent.

The March 1994 Settlement Agreement also required arbitration of any infringement claims. Pursuant to the March 1994 Settlement Agreement and the March 1994 License Agreement, the parties entered into a stipulation for dismissal of the DJ action with prejudice.

In 1997, Flex-Foot filed a complaint alleging that Springlite's "G-Foot" prosthetic foot device infringed the '363 patent (the "1997 Complaint"). In accordance with the March 1994 Settlement Agreement, the 1997 Complaint was sent to arbitration. In January 1999, Flex-Foot successfully obtained an arbitration award from the American Arbitration Association ("AAA"). That decision, rendered by a panel of three patent attorneys mutually selected by the parties, found that the accused Springlite device literally infringed asserted claims 16 and 17 of the '363 patent. The arbitration panel awarded Flex-Foot the costs of the arbitration. Soon thereafter, Springlite requested that the arbitrators clarify or modify their award, as well as set forth clear statements about the scope of the contested claim elements. The arbitrators declined both requests.

As a defense to the charge of infringement in the 1997 Complaint, Springlite alleged invalidity of the '363 patent, and subsequent to the arbitrators' award, filed a motion with the district court to vacate the award and consider the invalidity defense. In response, Flex-Foot filed a motion to affirm the arbitration award. The district court granted Flex-Foot's motion to confirm the arbitration award and entered a permanent injunction against Springlite, concluding that Springlite was "collaterally estopped" from challenging the validity and enforceability of Flex-Foot's '363 patent.

Springlite appeals the arbitration panel's award and the district court's judgment to this court. We have jurisdiction over Springlite's appeal from the district court's judgment.

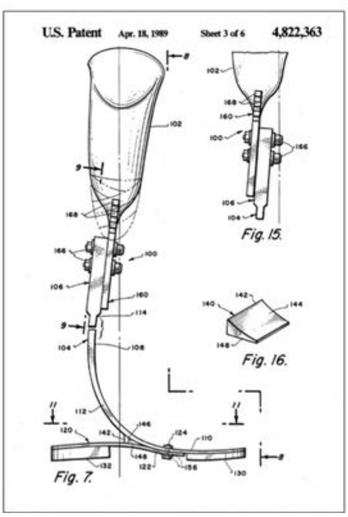

FIGURE 22.4 Flex-Foot's patented "bladerunner" prosthesis design gained worldwide attention when used by South Africa's Oscar Pistorius to run the 400 m sprint at the 2012 London Olympics.

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Discussion

The arbitration award did not address Springlite's challenge to the validity of the '363 patent. Upon … reviewing the award, the district court held that the validity of Flex-Foot's patents could not be litigated. It so held because it determined that Springlite was collaterally estopped from challenging the validity of the '363 patent, based on paragraph 7.1 of the March 1994 Settlement Agreement and paragraph 6 of the March 1994 Licensing Agreement.

Springlite argues that the district court's holding – that it is collaterally estopped from challenging the validity of the '363 patent – is in error. Springlite contends that it did not agree to enter into any type of judgment adjudicating the issues of infringement and validity. Despite Springlite's protestations, we note that Springlite did agree to a dismissal with prejudice following a settlement agreement that included a promise that Springlite would not challenge the validity of the '363 patent. We hold that … such a dismissal with prejudice and accompanying settlement agreement certainly gives rise to contractual estoppel of Springlite's challenge to the '363 patent's validity. The question is whether such contractually created estoppel is void as against public policy pursuant to *Lear v. Adkins*.

Springlite does not contend that its intent in entering into the March 1994 Settlement Agreement and March 1994 Licensing Agreement was anything other than a waiver of future challenges to the '363 patent's validity. Instead, Springlite argues that it should be entitled, under the public policy rationale set forth in Lear, to renege on its prior written agreement with Flex-Foot.

In *Lear*, notably, the license did not contain, and was not accompanied by, any promise by the licensee not to challenge the validity of the patent. This distinguishing fact is meaningful because it implicates the important policy of enforcing settlement agreements and res judicata. Indeed, the important policy of enforcing settlement agreements and res judicata must themselves be weighed against the federal patent laws' prescription of full and free competition in the use of ideas that are in reality a part of the public domain.

In addition to the present case being meaningfully distinguishable from *Lear*, we note that this court has in the past distinguished a number of other cases from *Lear*.

[*Hemstreet v. Spiegel, Inc.*, 851 F.2d 348 (Fed. Cir. 1988)] concerns settlement of an infringement trial that had progressed for a single week. The settlement, which included a stipulation requiring the licensee to make payments without regard to any subsequent determination of invalidity or unenforceability, was memorialized in a settlement order signed by the parties' representatives and the district court. The court's settlement order dismissed the action and stated that "the issues of validity, unenforceability and infringement of" the patents were finally concluded and disposed of. In a subsequent lawsuit, the parties disputed whether the settlement order created res judicata. We held that a dismissal based upon a settlement order in which "'the issues of validity, enforceability and infringement of' the patents in suit were finally concluded and disposed of," barred a subsequent challenge to the validity and enforceability of those patents by the same party, whether or not the settlement order and dismissal actually adjudicated patent validity to create res judicata. We also stated, "there is a compelling public interest and policy in upholding and enforcing settlement agreements voluntarily entered into" because enforcement of settlement agreements encourages parties to enter into them – thus fostering judicial economy.

Thus, the holding in *Hemstreet* was premised on the policy that while the federal patent laws favor full and free competition in the use of ideas in the public domain over

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the technical requirements of contract doctrine, settlement of litigation is more strongly favored by the law. Clearly, the importance of res judicata and its hierarchical position in the realm of public policy was not a relevant consideration in Lear and therefore the Supreme Court never evaluated the importance of res judicata and whether it trumps the patent laws' prescription of full and free competition in the use of ideas that are in reality a part of the public domain. See id.

This court had the occasion to revisit *Lear's* holding in [*Foster v. Hallco Mfg. Co.*, 947 F.2d 469 (Fed. Cir. 1991)]. *Foster* concerns termination of an infringement suit via a consent decree, i.e., a decision by the court to which the parties have agreed. In the consent decree, Foster acknowledged the validity and infringement of the patents at issue. About four years after entry of the consent decree, Foster began making a new device, and informed the patentee Hallco that the device did not infringe the patents at issue in the prior litigation. Hallco disagreed. When Foster subsequently filed a declaratory judgment action that the patents were invalid and unenforceable, Hallco asserted an affirmative defense of res judicata, based on the consent decree declaring that the patents are valid and enforceable. Foster alleged that, because the consent decree was essentially an agreement not to challenge the patent, it therefore was unenforceable under *Lear*.

We held that *Lear's* abrogation of licensee estoppel did not change the fact that a consent decree gives rise to res judicata. The *Foster* court could not conclude that the public policy expressed in *Lear* is so overriding that challenges to validity must be allowed when, under normal principles of res judicata applicable to a consent judgment, such judgment would be precluded. *Foster* echoes *Hemstreet's* teaching that there is a strong public interest in settlement of patent litigation and that upholding the terms of a settlement encourages patent owners to agree to settlements – thus fostering judicial economy. These interests are relevant to the instant case, even though this case deals with a settlement agreement and resulting dismissal with prejudice, rather than a consent decree.

> *"while the federal patent laws favor full and free competition in the use of ideas in the public domain over the technical requirements of contract doctrine, settlement of litigation is more strongly favored by the law"*

We note that this is the third litigation between Flex-Foot and Springlite. Springlite has already challenged the validity of the '363 patent twice, voluntarily ending that challenge via settlement and licensing agreements on both occasions. In the latest settlement agreement, Springlite promised not to challenge the validity and enforceability of the '363 patent. There has been no allegation that the latest settlement was anything other than a voluntary waiver of future challenges to the '363 patent's validity. Moreover, in this challenge, the parties conducted discovery and fully briefed opposing summary judgment motions on the issue of invalidity. The latest settlement occurred on the eve of the summary judgment briefing. Indeed, Springlite's behavior is exactly the type of behavior that both *Hemstreet* and *Foster* were concerned with when they noted the strong public interest in enforcing settlements. Settlement agreements must be enforced if they are to remain effective as a means for resolving legal disagreements. Upholding the terms of settlement agreements encourages patent owners to agree to settlements and promotes judicial economy.

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Once an accused infringer has challenged patent validity, has had an opportunity to conduct discovery on validity issues, and has elected to voluntarily dismiss the litigation with prejudice under a settlement agreement containing a clear and unambiguous undertaking not to challenge validity and/or enforceability of the patent in suit, the accused infringer is contractually estopped from raising any such challenge in any subsequent proceeding.

Based on the clear and unambiguous waiver of future challenges to the validity of the '363 patent in the settlement agreement voluntarily entered into by the parties in this case, we hold that Springlite is contractually estopped from challenging the validity of the '363 patent and affirm the district court's judgment in favor of Flex-Foot.

Notes and Questions

1. *Competing policy goals*. In *Flex-Foot*, the Federal Circuit relies on two earlier decisions, *Hemstreet* and *Foster*, which expressed different policy goals than *Lear*. In fact, the policy goals expressed in these cases appear to have been strong enough to overcome *Lear's* aversion restrictions on the ability to challenge patents on invalidity grounds. What policy goals were set forth in *Hemstreet* and *Foster*, and why are they more influential than those set forth in *Lear*?
2. *Beyond settlements? Flex-Foot* establishes that no-challenge clauses are enforceable in settlement agreements, given overriding policy considerations favoring the settlement of litigation. What other types of agreements might categorically be held to permit no-challenge clauses?
3. *What is a challenge? Lear* and most other cases interpreting a licensee's ability to "challenge" the validity of a licensed patent involve a licensee's assertion of the affirmative defenses of patent invalidity and unenforceability. But what about other actions that could narrow the scope of the licensed patent claims? Are these prohibited "challenges"?

   In *Transocean Offshore Deepwater Drilling, Inc. v. Noble Corp. PLC*, 451 F. Supp. 3d 690 (S.D. Tex. 2020), the parties had entered into a settlement agreement containing the following no-challenge clause:

   > Licensee covenants that it will not participate as a party or financially support a third party in any administrative or court proceeding or effort in the world to invalidate, oppose, nullify, reexamine, reissue or otherwise challenge the validity, enforceability, or scope of any claim of the Licensed Patents.

   In a subsequent infringement suit between the parties, the licensee argued that the licensor had disavowed claim scope by distinguishing prior art and proposed a construction of previously construed claim language that narrows the scope of the claim. The licensor argued that these actions amounted to "challenges" to the "scope of any claims of the Licensed Patents," in violation of the contractual no-challenge clause.

   The court, however, threw up its hands, holding that "the meaning of the language 'challenge the … scope of any claim' is uncertain and doubtful, and the language is reasonably susceptible to more than one meaning." Do you agree that the language of the no-challenge clause is irredeemably vague? If so, how would you amend this language so that it is sufficiently clear to prohibit (or allow) the licensee's actions? Does the language in the example clause above address the court's concern?

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22.4.2 *No-Challenge Clauses in Copyright and Trademark Licenses*

Lear was a patent case, and the public interest goals that it expressed were largely related to patents. But there are reasons that owners of other IP rights might like to include no-challenge clauses in their licensing agreements. Does *Lear* prohibit this? Or is the old doctrine of licensee estoppel still alive and well outside of patent law, making such contractual prohibitions unnecessary?

The Seventh Circuit considered these questions as they pertain to copyright in *Saturday Evening Post v. Rumbleseat Press, Inc.*, 816 F.2d 1191 (7th Cir. 1987). In 1979 the Saturday Evening Post Company granted Rumbleseat Press an exclusive license to manufacture porcelain dolls derived from certain Norman Rockwell illustrations that appeared in the *Saturday Evening Post*. Paragraph 9 of the license agreement provided that Rumbleseat "shall not, during the Original Term [of the agreement] or any time thereafter dispute or contest, directly or indirectly, [the] validity of any of the copyrights … which [the Post] may have obtained."

The Seventh Circuit found Saturday Evening Post's no-challenge clause to be valid and enforceable. Judge Richard Posner, writing for the court, first considered the salutary effects of such a clause:

FIGURE 22.5 Porcelain figurine based on a Norman Rockwell illustration.

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> Without it the licensee always has a club over the licensor's head: the threat that if there is a dispute the licensee will challenge the copyright's validity. The threat would discourage copyright licensing and might therefore retard rather than promote the diffusion of copyrighted works. Also, a no-contest clause might actually accelerate rather than retard challenges to invalid copyrights, by making the would-be licensee think hard about validity before rather than after he signed the licensing agreement. Rumbleseat had, in fact, used its expressed doubts of the validity of the Post's copyrights to obtain a lower royalty rate in the negotiations for the license.

He then discusses whether policy considerations, particularly those set forth in *Lear*, weighed against such clauses in copyright agreements. He finds that they do not, noting first that "the logic of *Lear* does not extend to copyright licenses." He explains:

> A patent empowers its owner to prevent anyone else from making or using his invention; a copyright just empowers its owner to prevent others from copying the particular verbal or pictorial or aural pattern in which he chooses to express himself. The economic power conferred is much smaller. There is no need for a rule that would automatically invalidate every no-contest clause. If a particular clause is used to confer monopoly power beyond the small amount that the copyright laws authorize, the clause can be attacked under section 1 of the Sherman Act as a contract in restraint of trade. Rumbleseat does not argue that the clause here restrained trade in that sense. The fact that we can find no antitrust case – or for that matter any other reported case – that deals with a no-contest clause in a copyright license is evidence that these clauses are not such a source of significant restraints on freedom to compete as might warrant a per se rule of illegality.

Thus, the court held that there were no countervailing policy considerations that weighed strongly against Saturday Evening Post's no-challenge clause, and upheld the clause.

A different result obtains, however, in the area of certification marks, as discussed in the following case.

Idaho Potato Comm. v. M&M Produce Farm & Sales

335 F.3d 130 (2d Cir. 2003)

FEINBERG, CIRCUIT JUDGE

Plaintiff Idaho Potato Commission ("IPC") appeals from a May 2002 Memorandum and Order ("May 2002 Order") of the United States District Court for the Southern District of New York (Brieant, J.), vacating a $ 41,962 jury award for the IPC in its certification mark infringement suit under the Lanham Act against M&M Produce Farm and Sales, M&M Packaging, Inc., and Matthew and Mark Rogowski individually (collectively "M&M").

Defendant M&M cross-appeals from the court's August 1998 Memorandum and Order ("August 1998 Order") … holding that M&M was barred from seeking cancellation of the IPC marks by a no-challenge provision in its licensing agreement with the IPC. M&M argues on appeal that the no-challenge provision should not be enforced because it violates the public policy embodied in the Lanham Act.

Background

The IPC is an agency created by Idaho statute to promote the sale of Idaho russet potatoes and to prevent the substitution of potatoes grown in other regions as Idaho potatoes. To

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further these goals, the IPC has registered a number of certification marks with the United States Patent and Trademark Office, two of which are relevant to this appeal: (1) the word "IDAHO" in a distinctive font; and (2) the phrase "GROWN IN IDAHO" written inside an outline of the boundaries of the state of Idaho (collectively "the IPC marks"). Each mark certifies that "goods so marked are grown in the State of Idaho."

The IPC controls its marks through an elaborate licensing system that seeks to ensure the quality and geographic authenticity of potatoes packed in containers bearing the IPC marks. This system requires everyone in the chain of distribution, from in-state growers to out-of-state repackers and resellers, to be licensed in order to use the IPC certification marks on their packaging. Licensed vendors are also prevented from selling Idaho potatoes to non-licensed customers for repacking or reselling.

The standard licensing agreements provide licensees with the right to use the IPC marks, an important benefit because certified Idaho potatoes sell for more than non-Idaho potatoes. In return, licensees agree, among other things, to use the IPC marks only on potatoes that are certified as grown in Idaho and that meet the IPC's other quality standards. Licensees also agree to maintain purchase and sale records so that the IPC can check periodically for compliance and prevent "counterfeiting" (putting non-Idaho potatoes in bags bearing the IPC marks.)

M&M is a small business in New York owned and operated by two brothers, Matthew and Mark Rogowski. M&M's main business is growing onions on a small farm, but because onions are a seasonal crop, the brothers also repack potatoes to stay in business throughout the year. In 1990, M&M entered into a licensing agreement with the IPC and was given the right to use the IPC's certification marks, subject to the terms in the agreement. While M&M was a licensee, it would purchase potatoes in bulk from licensed Idaho potato vendors and would repackage those potatoes into small five-pound bags bearing the certification marks.

In 1994, M&M received a notice of audit from the IPC requesting M&M's records with regard to all Idaho potatoes bought and sold. Because M&M did not produce sufficient records, the IPC considered M&M in breach of the licensing agreement and requested that M&M return its license. In February 1995, M&M voluntarily gave up the license and consequently no longer had the right to use the IPC marks.

After returning the license, however, M&M continued repacking Idaho potatoes in bags with the IPC marks.

FIGURE 22.6 One of the Idaho Potato Commission's certification marks for Idaho-grown potatoes.

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In November 1997, the IPC filed the current lawsuit against M&M alleging: (1) trademark infringement, (2) false designation of origin and dilution, and (3) unlawful and unfair competition in violation of various New York and Idaho statutes and common law.

In response, M&M filed counterclaims for, among other things, cancellation of the IPC marks under federal and state law. M&M argued that the IPC marks should be cancelled for numerous reasons, including that the IPC abused its marks by: discriminately refusing to certify potatoes that were grown in Idaho, imposing standards for certification beyond the geographic origin the marks are registered to certify, and using its certification marks for purposes other than to certify, all in violation of the Lanham Act. M&M also alleged that the IPC lacks the independence necessary for certification mark owners under the Lanham Act.

[The district] court held [in the August 1998 Order] that M&M was estopped from challenging the IPC marks by a provision in its licensing agreement in which M&M (1) acknowledged that the marks "are valid, registered marks;" and (2) agreed that it would "not during the term of the agreement, or at any time thereafter, attack the title or any rights" of the IPC in the relevant marks.

M&M cross-appeals from the August 1998 Order holding M&M estopped from attacking the validity of the IPC marks.

Discussion

Because the jury's verdict against M&M was predicated on the IPC's ownership of valid certification marks, we first discuss M&M's cross-appeal challenging the district court's August 1998 ruling that M&M was … estopped by the licensing agreement from attacking those marks.

The facts relevant to the issue are not in dispute. M&M signed a licensing agreement with the IPC in which M&M recognized the validity of the IPC marks and promised not to attack the rights of the IPC in those marks during the term of the agreement or at any time thereafter. The basic question on the facts before us, therefore, is whether such a provision in a certification mark licensing agreement is enforceable against a licensee when the licensee no longer holds a license. This question has apparently not yet been squarely decided by any federal circuit court.

M&M contends that the no-challenge provision in its licensing agreement should not be enforced because it violates the public policy embodied in the Lanham Act. It argues that by requiring licensees to forever waive their statutory right to challenge the IPC's marks, the IPC effectively avoids enforcement of the Lanham Act. M&M relies principally on the Supreme Court's opinion in *Lear, Inc. v. Adkins*, which held that the contract doctrine of licensee estoppel was trumped by the federal policy embodied in the patent laws. M&M argues that *Lear* should apply to certification mark licenses as it does to patent licenses because the public interest in both is similar.

We begin our analysis with the Supreme Court's opinion in *Lear*. The general rule of licensee estoppel provides that when a licensee enters into an agreement to use the intellectual property of a licensor, the licensee effectively recognizes the validity of that property and is estopped from contesting its validity in future disputes. As noted above, the Supreme Court in *Lear* held that the doctrine does not necessarily control in disputes over the validity of patents. The Court identified in the patent laws the "strong federal policy favoring the full and free use of ideas in the public domain."

Courts applying the principles articulated in *Lear* to patent disputes have enforced no-challenge contract provisions only when the interests in doing so outweigh the public interest in discovering invalid patents. Thus, in *Flex-Foot*, the United States Court of Appeals for the Federal Circuit recently enforced an estoppel provision in a settlement agreement only after determining that the public policy in favor of settlements outweighed the public interest in patents.

Other courts, including this one, have weighed these interests to reach differing results, but each has recognized the applicability of the balancing test first articulated in *Lear*.

The *Lear* balancing test has also been frequently applied to trademark licensing contracts. As the district court here correctly noted, courts in this context have generally precluded licensees from challenging the validity of a mark they have obtained the right to use. However, courts have done so only after considering the public interest in trademarks. For example, in *Beer Nuts, Inc. v. King Nut Co.*, the Sixth Circuit explicitly used the *Lear* balancing test in upholding a written agreement not to challenge the validity of a trademark. The court distinguished the public policy of trademarks—guarding the public from being deceived into purchasing an unwanted product—from that of patents and held, "When the balancing test is employed in the instant situation, we conclude that the public interest in [trademarks] … is not so great that it should take precedence over the rule of the law of contracts that a person should be held to his undertakings."

The IPC maintains that the *Lear* balancing test is inapplicable because unlike the contract in *Lear*, which was silent concerning the rights of the licensee to challenge the patent, the contract signed by M&M specifically precluded M&M from challenging the IPC's marks. However, this distinction does not negate the applicability of the *Lear* balancing test to the contract in this case. *Lear* itself recognized that federal policy embodied in the law of intellectual property can trump even explicit contractual provisions. The licensor in *Lear* argued that based on the licensee's explicit contractual agreement to pay royalties until invalidity of the patent had been determined by a court, the licensee was required to pay royalties for the duration of the litigation even if the patent in question was eventually declared invalid. The *Lear* Court disagreed and refused to enforce the contract on the same basis that it refused to apply licensee estoppel: "The parties' contract, however, is no more controlling on this issue than is the State's doctrine of estoppel, which is also rooted in contract principles." *Lear* makes clear that courts should weigh the federal policy embodied in the law of intellectual property against even explicit contractual provisions and render unenforceable those provisions that would undermine the public interest. Thus, the explicit contractual provision in the licensing agreement between the IPC and M&M is no barrier to application of the *Lear* balancing test.

We turn now to application of this balancing test to the current dispute. In doing so, we must identify the public interest in certification marks and the public injury that might result from enforcement of the estoppel provision in the contract between M&M and the IPC. The IPC argues, and the district court agreed, that the trademark cases enforcing no-challenge provisions noted above are controlling with regard to certification marks because "certification marks are generally treated the same as trademarks." Although we recognize that trademarks and certification marks are "generally treated the same," we conclude that the difference between the public interests in certification marks and trademarks compels a different result in this context.

In the trademark context … "[a] dealer's good will is protected … in order that the purchasing public may not be enticed into buying A's product when it wants B's product."

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Thus, agreements that allow the continued use of confusingly similar trademarks injure the public, and the important issue in litigation over trademark contracts is the public confusion that might result from enforcing the contract.

Significantly, trademark owners are granted a monopoly over their marks and can choose to license the marks to others on whatever conditions they deem appropriate, so long as confusion does not result. The same is not true of certification marks. Certification mark licensing programs are "a form of limited compulsory licensing," 3 McCarthy on Trademarks and Unfair Competition § 19.96, and the certifier has a "duty … to certify the goods or services of any person who meets the standards and conditions which the mark certifies."

That the owner of a certification mark "cannot refuse to license the mark to anyone on any ground other than the standards it has set," 3 McCarthy at § 19.96, is an important distinction between the policies embodied in trademarks and certification marks. It is true that certification marks are designed to facilitate consumer expectations of a standardized product, much like trademarks are designed to ensure that a consumer is not confused by the marks on a product. But the certification mark regime protects a further public interest in free and open competition among producers and distributors of the certified product. It protects the market players from the influence of the certification mark owner, and aims to ensure the broadest competition, and therefore the best price and quality, within the market for certified products. From our review of the cases, it appears to us that this interest is akin to the public interest in the "full and free use of ideas in the public domain" embodied in the patent laws. *Lear*, 395 U.S. at 674.

We believe that the estoppel provision in the contract between M&M and the IPC injures this public interest in a number of ways. First, the provision places a non-quality-control related restriction on the sellers of the certified product and other licensees that benefits the mark owner in contravention of the mark owner's obligation not to interfere with a free market for products meeting the certification criteria. Second, as in *Lear*, parties that have entered into a licensee relationship with the IPC may often be the only individuals with enough economic incentive to challenge the IPC's licensing scheme, and thus the only individuals with enough incentive to force the IPC to conform to the law.

Finally, to decide the issue of public injury we must look to the public interest implicated by the merits of the licensee's challenges. M&M alleges, among other things, that: (1) the IPC is a corporate entity dominated by producers of the certified products and that such domination violates the provisions in 15 U.S.C. § 1064(5)(B); (2) the IPC uses the goodwill derived from the certification marks as a trademark in violation of § 1064(5)(C); (3) the IPC imposes certification standards other than those that the certification mark is registered to certify in violation of § 1064(5)(D); and (4) the IPC discriminately refuses to certify potatoes that meet the standards for certification, also in violation of § 1064(5)(D). All of these challenges implicate the public interest in maintaining a free market for the certified product unaffected by the possible competing economic interests of the certification mark owner.

We believe these public interests are more substantial and more likely to be harmed if M&M is not allowed to press its claims than the public interests and de minimis harm alleged in the trademark-related cases that upheld contractual no-challenge provisions. See, e.g., *Beer Nuts*, 477 F.2d at 329 (holding that public interest in guarding against depletion of general vocabulary insufficient to override contract law). Also, this case lacks a strong countervailing public interest other than the general interest in enforcing written contracts (like the interest in settlements) that persuaded courts to enforce contractual no-challenge provisions in other agreements. See, e.g., *Flex-Foot*, 238 F.3d at 1368. We therefore conclude that the district court erred in finding M&M contractually estopped as a matter of law from challenging the IPC marks.

[W]e therefore vacate the district court's August 1998 Order holding M&M estopped as a matter of law from bringing its counterclaims for cancellation of the IPC marks and remand for consideration of those claims on the merits.

Notes and Questions

1. Lear *beyond patents*. Why does Judge Posner conclude that the reasoning of *Lear* should not be extended to copyrights? Are the policies expressed in Lear limited solely to patents? Do you agree with limiting *Lear* in this manner? In *Idaho Potato*, Judge Feinberg does not seem to display the same reluctance to apply *Lear* in the context of trademarks. What might account for this difference in approaches?
2. *Economic power*. Do you agree with Judge Posner's statement in *Saturday Evening Post* that the "economic power" conferred by copyrights is "much smaller" than that conferred by patents? Surely some copyrights are more valuable than others, just as some patents are more valuable than others and, by extension, some copyrights are more valuable than some patents. Is Judge Posner's reasoning, then, based on a law of averages?
3. *The rarity of copyright invalidity*. In *Saturday Evening Post*, "the Post had copyrighted each of the magazines in which the [Norman Rockwell] illustrations appeared but had not copyrighted the illustrations separately." This omission caused Rumbleseat to question the validity of the Post's copyright in the illustrations. Such an omission, however, is relatively rare, and today, with the elimination of the copyright registration requirement, a nonissue. Is this why Judge Posner observed that "we can find no … other reported case that deals with a no-contest clause in a copyright license"? Compare this situation with that of patents, every one of which can be (and usually is) subject to a validity challenge when asserted. Does the relative infrequency of copyright validity challenges make the decision in *Saturday Evening Post* easier? Note that Judge Posner is careful to distinguish between the validity of the Post's copyrights in the Rockwell illustrations and "the copyrightability of the Rockwell dolls." Why bother to make this distinction? Would the result change if the no-challenge clause related to the copyrightability of a porcelain doll, or possibly a software program?
4. *The* Lear *balancing test*. In *Idaho Potato*, Judge Feinberg views *Lear* as requiring a court to "balance" the "strong federal policy favoring the full and free use of ideas in the public domain" against whatever policy factors favor the enforcement of a particular no-challenge clause. He refers numerous times to the *Lear* "balancing test." Yet neither the Supreme Court in *Lear* nor the Federal Circuit in its major opinions applying *Lear* refer to such a "balancing test." Is Judge Feinberg's characterization of *Lear* accurate? If so, why do so few courts assessing no-challenge clauses in patent cases use this terminology?
5. *Public policy and certification marks*. Judge Feinberg identifies separate public policies concerning a party's ability to challenge the validity of trademarks and certification marks. What are these different public policy interests and why are they so different?

   In reviewing earlier trademark cases such as *Beer Nuts*, he seems to acknowledge that "the public interest in [trademarks] … is not so great that it should take precedence over the rule of the law of contracts that a person should be held to his undertakings." Yet in striking

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down the Idaho Potato Commission's no-challenge clause, he favorably compares the strong public policy interests favoring challenges to potentially invalid certification marks, as well as other behaviors of certification mark owners. But unlike the enforceability of settlement agreements, which, under *Flex-Foot*, is supported by a strong public interest, the interest of certification mark owners in no-challenge clauses is a mere "general interest in enforcing written contracts." As a result, the factors supporting challenges to certification marks outweigh those supporting no-challenge clauses, and the Commission's no-challenge clause was rejected. Do you agree with the results of Judge Feinberg's various balancing exercises? Why isn't the goal of trademarks – avoiding consumer confusion – as or more important than the goal of certification marks?

Review the below summary of the state of the law regarding no-challenge clauses in licensing agreements for different types of IP. Do these rules make sense to you? What, if anything, would you change?

SUMMARY: LEGAL STATUS OF NO-CHALLENGE CLAUSES IN LICENSING AGREEMENTS

Patents – generally barred (*Lear*), but permitted in settlement agreements (*Flex-Foot*)
Copyrights – generally permitted (*Saturday Evening Post*)
Trademarks – generally permitted (*Beer Nuts*)
Certification Marks – generally barred (*Idaho Potato*)

22.4.3 *Other Penalties for Validity Challenges*

As discussed in the preceding sections, no-challenge clauses are not likely to be enforced in nonsettlement patent licensing agreements. As a result, licensors have developed a set of alternative contractual provisions that seek to discourage licensees from challenging the validity of licensed IP, and to penalize those that do.

Licensee Patent Validity Challenges Following *MedImmune*: Implications for Patent Licensing

Alfred C. Server & Peter Singleton, 3 *Hastings Sci. & Tech. L.J.* 243, 417–38 (2010)

Considering the various problems and uncertainties associated with the "no-challenge" clause, it is reasonable to conclude that its use in a typical license agreement should be avoided. As we will see in the sections that follow, other pro-licensor contract provisions can be used, whether alone or in combination, that have a far greater likelihood of being enforceable and are associated with significantly less risk of giving rise to unintended consequences.

"Termination-for-Challenge" Clause

A "termination-for-challenge" clause, also referred to as a "no-challenge termination" clause, confers upon a patent licensor the right to terminate the license agreement in

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the event that the licensee challenges the validity of the licensed patent. If enforceable, the provision provides a contractual means of counteracting the effect of the Supreme Court's *MedImmune* decision, which relieved a licensee of the jurisdictional requirement of having to repudiate its patent license agreement before challenging the licensed patent. By permitting a licensor to terminate the license agreement upon the licensee's patent challenge, the "termination-for-challenge" clause places the licensee in the same position it would have been in prior to the *MedImmune* Court's rejection of the Federal Circuit's *Gen-Probe* holding, i.e., in order to bring a patent challenge, a licensee is required to risk losing the benefits of its patent license. Not surprisingly, the "termination-for-challenge" clause is encountered with increasing frequency in the aftermath of [*MedImmune*]. However, the question of whether the clause is enforceable is not a simple one.

Unlike the "no-challenge" clause, a "termination-for-challenge" clause does not eliminate one of the protections of the *Lear* doctrine. In the words of one commentator, "[t]his type of contractual provision does not bar a licensee from challenging the patent's validity. It merely gives the licensor the right to terminate the license in such a case, enabling the licensor to sue the licensee for infringement."[10] The "termination-for-challenge" clause differs from the "no-challenge" clause in another important respect. While the latter has been the subject of judicial review on a number of occasions (as discussed in the preceding section), the "termination-for-challenge" clause has only rarely been evaluated by a court.

One such evaluation was provided … in *Bayer AG v. Housey Pharmaceuticals, Inc.*, 228 F. Supp. 2d 467 (D. Del. 2002). Bayer, the plaintiff in the case, sought a declaratory judgment that the Housey patents were unenforceable as a result of Housey's misuse of the patents.[11] Among the alleged acts of misuse was the inclusion in patent license agreements with third parties of the following provision:

> [LICENSOR] acknowledges the LICENSEE is not estopped from contesting the validity or enforceability of the Licensed Patent Rights. However, LICENSEE acknowledges that such an attack on validity or enforceability of the Licensed Patent Rights is inconsistent with the purposes of this License Agreement. Accordingly, LICENSEE hereby agrees that if it decides to assert its right to contest the Licensed Patent Rights, in whole or in part, that … [LICENSOR] shall have the right, at … [LICENSOR's] option, to terminate this License Agreement by giving written notice thereof to LICENSEE. Further, unless terminated by … [LICENSOR], LICENSEE agrees to make all payments due under this License Agreement notwithstanding any challenge … by LICENSEE … to the Licensed Patent Rights, so long as the applicable patent(s) or patent application(s) remain in effect.

Bayer contended that the provision was an attempt "to muzzle licensees in violation of *Lear*" and its presence in the Housey license agreements constituted patent misuse. The district court in *Bayer* began its analysis by restating the dual protections afforded a patent licensee under the *Lear* doctrine, namely, that a licensee cannot be barred from challenging the validity of a licensed patent nor required to pay royalties to the licensor during the pendency of its patent challenge. Concluding that neither of these protections can be eliminated by the agreement of contracting parties, the court held that the portion of the

10 Christian Chadd Taylor, No-*Challenge Termination Clauses: Incorporating Innovation Policy and Risk Allocation into Patent Licensing Law*, 69 Ind. L.J. 231 (1993).

11 The doctrine of patent misuse is discussed in Chapter 24.

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Housey provision under consideration that obligated the licensee to continue to pay royalties while challenging the licensed patent was unenforceable. The court went on to note, however, that the inclusion of this unenforceable portion of the provision in the Housey license agreements did not constitute patent misuse. What is significant for the purpose of this section is that the *Bayer* court found no fault with the "termination-for-challenge" portion of the Housey provision. The fact that the district court selectively rejected the royalty payment portion of the provision suggests that the basis for the rejection was that that portion of the provision, in contrast to the "termination-for-challenge" portion, directly eliminated one of the protections of the *Lear* doctrine.

The *Bayer* decision, however, is only a tacit endorsement of the "termination-for-challenge" clause, and questions as to the provision's enforceability remain to be answered …

In the end, a decision by a patent licensor to use a "termination-for-challenge" clause in its license agreement involves a degree of uncertainty that is not likely to be lessened in the near future, but such a decision is probably justified on the basis of the available information. Unlike in the case of a typical "no-challenge" clause, which eliminates one of the protections of the *Lear* doctrine and is almost certainly unenforceable, there is credible support for the enforceability of a "termination-for-challenge" clause.

Royalty Payment Provisions

Another type of pro-licensor contract provision that is receiving increasing attention is one that links a licensee's patent validity challenge with its obligation to pay royalties under the license agreement. This type of provision can vary on the basis of the event that triggers a consequence (e.g., the patent challenge itself as opposed to the failure of the challenge) and the nature of the consequence (e.g., a continuing obligation to pay the agreed-to royalties as opposed to an increase in the royalty amount to be paid by the licensee). At least one variation of this type of provision has been ruled unenforceable in that it eliminated one of the protections of the *Lear* doctrine. Other variations, however, are likely to be enforceable, especially one that requires an increase in the royalty payment obligation of a licensee whose patent challenge fails, reflecting the added value of a patent that has been adjudicated as valid.

The relationship between a patent licensee's right to challenge the validity of the licensed patent and its obligation to pay royalties was originally explored in *Lear*. Recall that the Supreme Court in *Lear* ruled that an express contractual obligation of a licensee to pay royalties "until such time as the 'patent *** is held invalid,'" effectively requiring the licensee to pay during the pendency of any patent challenge, is unenforceable (the second prong of the *Lear* doctrine). According to the *Lear* Court, such an obligation would encourage a licensor to postpone a final determination regarding the licensed patent's validity and could deter the licensee from bringing the patent challenge in the first place, thereby frustrating the public's interest in eliminating worthless patents. Considering the holding in *Lear*, it is not surprising that a district court in *Bayer* rejected a royalty payment provision that stated that

> LICENSEE agrees to make all payments due under this License Agreement notwithstanding any challenge … by LICENSEE … to the Licensed Patent Rights, so long as the applicable patent(s) or patent application(s) remain in effect.

As was already discussed in the preceding section, the Bayer court concluded that the provision was unenforceable in that it impermissibly eliminated one of the protections of the *Lear* doctrine, but its inclusion in the license agreement was not patent misuse.

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The *Bayer* court did not consider the question of whether a licensee that exercises its *Lear*-protected right to withhold agreed-to royalties during the pendency of its patent challenge and, thereby, breaches an unenforceable royalty payment provision such as the one under consideration in the case could have its license agreement terminated by the licensor on the basis of the breach. [P]ost-*Lear* district court decisions … support the view that the nonpayment of agreed-to royalties associated with a patent challenge is an insufficient basis for the termination of a license agreement, in light of the public's interest in the early adjudication of patent invalidity. In contrast, the Federal Circuit's "challenge-but-face-the-consequence" [e.g., *Gen-Probe* – Ed.] decisions take the position that a breach by a licensee of a contractual provision in the course of bringing a patent challenge can subject the licensee to an unwanted consequence, including the loss of rights under the license agreement, despite the public policy articulated in *Lear*.

While a royalty payment provision that eliminates one of the protections of the *Lear* doctrine (such as the one rejected in *Bayer*) is almost certainly unenforceable, assessing the enforceability of other pro-licensor royalty payment provisions presents a greater challenge. For example, one of the provisions that has been suggested in response to [*MedImmune*] would require a licensee that brings a patent validity challenge to pay increased royalties. The U.S. Government, in its *MedImmune* Brief, noted that such a provision could "anticipate and ameliorate the effects of the filing of a declaratory judgment action by a licensee [challenging the validity of the licensed patent]." However, as stated in the Government's Brief, the enforceability of such a provision "is an open question in light of the strong public policy favoring patent challenges as reflected in *Pope* and *Lear*." A provision that burdens a patent licensee with an unwanted consequence for the mere act of challenging the validity of the licensed patent could be viewed as too much of a disincentive to challenge to be compatible with the "spirit of *Lear*."

One way to lessen the impact of a pro-licensor contract provision that calls for an increase in a licensee's royalty payment obligation following a patent challenge is to have the increase triggered only by an unsuccessful challenge by the licensee, i.e., one in which the challenged patent is ultimately adjudicated as valid. There is a reasonable basis for such a royalty increase that is not punitive in nature, namely, that a patent that has been adjudicated as valid is of greater value than one that is merely presumed to be valid as a result of its issuance.

A number of other royalty payment provisions have been proposed to account for the increased likelihood of a licensee patent validity challenge following [*MedImmune*], although to the authors' knowledge none has undergone judicial review where compatibility with *Lear* was at issue. Some of these provisions are intended to maximize a licensor's return on a licensed patent prior to any patent challenge by the licensee (e.g., requiring the licensee to pay a higher royalty from the outset than would otherwise have been sought in the absence of the increased threat of a challenge). Other provisions are designed to guarantee the continuation of a licensee's royalty payment despite a patent challenge (e.g., making the royalty payment obligation independent of the validity of the licensed patent). Putting aside the question of whether a licensee would agree to any of these royalty payment provisions, each such provision must be assessed for its enforceability and effect … What can be said with respect to all of these provisions is the following: (1) the more punitive the provision, burdening a licensee for merely exercising its *Lear*-protected right to challenge the validity of the licensed patent, the greater the risk of unenforceability, and (2) the possibility that the inclusion of the provision in a patent license agreement constitutes patent misuse must be given careful consideration.

Other Pro-Licensor Contract Provisions

In the aftermath of [*MedImmune*], patent licensors have been particularly active in crafting pro-licensor contract provisions to account for an increased likelihood of a licensee patent validity challenge.

A contract provision that is increasingly popular among patent licensors requires that a licensee that intends to challenge the validity of the licensed patent provide advanced notice to the licensor and disclose the basis for the challenge. The following is an example of such a provision:

> In the event LICENSEE intends to assert in any forum that any LICENSED PATENT is invalid …, LICENSEE will, not less than ninety (90) days prior to making any such assertion, provide to LICENSOR a complete written disclosure of each and every basis then known to LICENSEE for such assertion and, with such disclosure, will provide LICENSOR with a copy of any document or publication upon which LICENSEE intends to rely in support of such assertion. LICENSEE's failure to comply with this provision will constitute a material breach of this Agreement.[12]

A provision of this type will allow for a dialogue between licensor and licensee that may avert a patent challenge and will, if necessary, aid the licensor in its preparation of a defense of its patent.

Other pro-licensor contract provisions are intended to limit the information available to a licensee in its challenge of the licensed patent. For example, a patent license agreement may contain a provision that expressly prohibits the licensee from using any confidential information of the licensor, provided to the licensee under the agreement, in challenging the licensed patent. An even more restrictive provision has been suggested that "requir[es] … that the licensee disclose the prior art it knows about before entering the license, and provid[es] … that the licensee will have the right to challenge validity in defense to an action for royalties, or as [a] declaratory judgment claim based only on other and closer prior art that the licensee learns of after entering the license."[13]

One of the more frequently encountered pro-licensor provisions obligates a licensee that challenges the validity of the licensed patent to pay the patent holder's litigation costs, including attorney's fees, that result from the challenge. Such a provision varies on the basis of whether the licensee's payment obligation attaches irrespective of the success of its challenge or only in the event that the patent challenge fails.

The list of pro-licensor contract provisions, to be used alone or in combination, will grow as creative transactional attorneys continue to grapple with the increased likelihood of a licensee patent validity challenge following *MedImmune*. In the absence of case law confirming the enforceability of such a provision, its inclusion in a patent license agreement will entail a degree of uncertainty … In the end, however, a number of pro-licensor contract provisions will fall within a gray zone where a finding of patent misuse is unlikely, but the question of enforceability will remain open until resolved by a court. The licensor

[12] Brian G. Brunsvold & Dennis P. O'Reilley, Drafting Patent License Agreements, 169–70 (5th ed., BNA Books, 2004).

[13] John W. Schlicher, *Patent Licensing, What to Do After* MedImmune v. Genentech, 89 J. Pat. & Trademark Off. Soc'y 364, 392 (2007).

inclined to incorporate such a provision will need to be advised as to the risk of unenforceability, which risk increases to the extent that the provision appears to penalize a licensee for a patent validity challenge in a manner and to a degree that is likely to prevent the challenge in the first place, thereby frustrating the important public interest, articulated in *Lear*, in eliminating worthless patents.

SUMMARY: OTHER CONTRACTUAL PENALTIES FOR VALIDITY CHALLENGES

- Termination-on-challenge
- Loss of exclusivity
- Payment of royalties required during challenge
- Royalty increases upon challenge
- Royalty increases upon unsuccessful challenge
- Licensee advance notice of challenges
- No use of licensor's confidential information in making any challenge
- Licensee disclosure of known prior art and limitation of challenges to that art
- Licensee bears licensor's legal costs, win or lose
- Mandatory arbitration of validity disputes

Notes and Questions

1. *Untested clauses*. Server and Singleton describe a range of contractual provisions that have been used in lieu of no-challenge clauses to deter licensees from challenging the validity of licensed patents. None of these provisions have been tested in the courts. As such, how would you advise a licensor client that wished to include such clauses in a licensing agreement? How would you describe the risks and benefits of such clauses?
2. *Value of adjudicated patents*. Server and Singleton reason that "a patent that has been adjudicated as valid is of greater value than one that is merely presumed to be valid as a result of its issuance." Why would this be the case? What impact does such an observation have on the enforceability of clauses triggered by patent validity challenges?
3. *Arbitration of validity challenges*. Why might some licensors prefer that licensee challenges to the validity of licensed patents be resolved through binding arbitration rather than litigation? Consider the effect of arbitral decisions on other current or future licensees.

Problem 22.1

Your client, Monop O. Liszt, is a famed pianist who has developed a suite of ingenious music synthesis software applications. He has applied for patents on these inventions and has registered the copyrights in the software source code. Liszt now wishes to license his software on a nonexclusive basis to computer, electronic keyboard, film production and music distribution companies around the world. Because he is an individual without a large litigation budget, however, he would like to limit the ability of his licensees to challenge his IP rights. Prepare a draft set of provisions that you would recommend inserting into his standard form of software licensing agreement to achieve this goal, explaining the relative risks and benefits of each provision.