

## Dealing With MedImmune

--By James R. Ferguson, Mayer, Brown, Rowe & Maw LLP

*Wednesday, March 14, 2007* --- In *MedImmune v. Genentech*, 127 S. Ct. 764 (2007), the Supreme Court held that a patent licensee does not have to repudiate the license in order to file a declaratory judgment action challenging the validity of the underlying patent.

Many observers believe that this decision will fundamentally alter the negotiating positions of prospective licensors and licensees. Until *MedImmune*, a licensee could not make a validity challenge without first repudiating the license, refusing to pay royalties and infringing the patent.

The licensee would then face major risks in a patent infringement litigation, including the possibility of a treble damages award and a permanent injunction.

Now, in the wake of *MedImmune*, a licensee can challenge the patent in a declaratory judgment action while maintaining the legal right to continue to use the patented invention. This, of course, eliminates the most serious risks of litigation for the licensee. As a result, *MedImmune* arguably creates incentives for licensees to challenge patents whenever the projected royalties are significantly higher than the expected costs of a lawsuit.

To be sure, as some observers have noted, *MedImmune* decided only a jurisdictional issue without addressing the merits of a patent challenge by a non-repudiating licensee.

But at a minimum, *MedImmune* creates a great deal of uncertainty about a patent owner's ability to prevent a licensee from successfully pursuing such a challenge.

This uncertainty is especially problematic for patent owners who are negotiating a license as part of a settlement agreement to terminate a patent infringement suit. If the alleged infringer can enter into a patent license but still be able to challenge the patent in the future, the patent owner can achieve no finality by settling the lawsuit.

As it turns out, such problems can be effectively addressed through carefully drafted provisions in patent licenses and settlement agreements. Indeed, under current law, a patent owner has several options to protect his interests through enforceable provisions that reduce a licensee's incentives to initiate a patent challenge.

### \* Patent Licenses After *MedImmune* \*

One obvious response to *MedImmune* is a license provision barring the licensee from initiating any challenge to the underlying patent. However, this option may not be viable in light of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

---

In *Lear*, the Supreme Court struck down the doctrine of licensee estoppel which precluded a licensee from challenging the validity of the underlying patent.

The Court also held that a licensee could not be forced to make royalty payments while challenging the validity of the patent. The Court based its holdings on the federal interest in eliminating “specious patents” and promoting the “free use of ideas in the public domain.”

Most courts have interpreted *Lear* to outlaw any license provision barring the licensee from challenging the patent. This does not mean, however, that the patent owner cannot reduce the incentives for the licensee to make such a challenge.

One possibility is to require prospective licensees to purchase a fully paid-up license—or to make large upfront payments—rather than pay continuous royalties over time. This option would seek to capitalize on the general rule that, in the absence of fraud, a licensor can retain royalties paid prior to the filing of a patent infringement suit, even if the litigation results in a finding of patent invalidity. The upfront payments would thus reduce the economic incentives to initiate a later challenge to the patent.

This approach, however, will not always be feasible. In some cases, the patent owner will be reluctant to rely on large upfront payments because he cannot fully assess the amount he would receive on a continuing royalty basis. In other cases, the prospective licensee will be reluctant to make large upfront payments because he has not yet developed a commercially successful product that exploits the patented invention.

When upfront payments are not feasible, another alternative is a provision giving the patent owner a termination option if the licensee contests the validity of the patent. Such a clause would not prevent the licensee from challenging the patent in litigation, but it would effectively circumvent *MedImmune* by requiring the licensee to choose between keeping the license and filing the lawsuit. If the licensee opted to challenge the patent, he would not avoid the risks of a permanent injunction and a treble damages award.

Still another option is to provide for adverse consequences (such as an increased royalty rate or the payment of attorneys’ fees) if the licensee initiates an unsuccessful patent challenge. As noted earlier, in *Lear*, the Supreme Court held that a licensor couldn’t require a repudiating licensee to make royalty payments while challenging the validity of the patent. This holding, however, does not preclude the licensor from increasing the amount of the royalty payments (or requiring the payment of attorneys’ fees) in the event of an unsuccessful challenge to the patent.

None of these options is foreclosed by *MedImmune*, which merely held that federal courts have jurisdiction to entertain a declaratory judgment action brought by a non-repudiating licensee. The case did not hold that licensees have a right to bring such an action while keeping the license and suffering no adverse consequences.

Of course, a termination provision or large up-front payments could deter some licensees from challenging invalid patents and thus undermine *Lear*’s policy interest in eliminating “specious

patents.” But this interest is far less compelling when the adverse consequences are triggered only by an unsuccessful patent challenge—which, by definition, does not involve an invalid patent.

In any event, licensors have good reason to draft agreements that include some (or all) of the above options, together with a severability clause to increase the likelihood that one or more of the options will survive a legal challenge.

\* Settlement Agreements After MedImmune \*

If the patent license is part of an agreement that terminates a patent infringement litigation, the patent owner has much more latitude in drafting enforceable provisions that bar future challenges to the patent.

The most effective approach is to draft an agreement that requires the entry of a consent judgment in which the alleged infringer (now putative licensee) stipulates that the patent claims are valid and the licensee will not mount any future challenge to the patent.

If properly drafted, such a promise will be enforceable as a matter of both contract law and *res judicata*—the legal doctrine precluding the relitigation of any cause of action (or defense) that has ended in a court judgment.

This is the holding of *Foster v. Hallco Manufacturing Co. Inc.*, 947 F.2d 469 (Fed. Cir. 1991). In that case, the Federal Circuit rejected an alleged infringer’s claim that Lear precluded the trial court from giving *res judicata* effect to a consent decree affirming the validity and enforceability of the underlying patent.

The Federal Circuit held that the policy considerations underlying Lear did not trump the *res judicata* effect of a consent judgment, particularly in light of the powerful countervailing interest in encouraging settlements of patent infringement litigation.

The Federal Circuit further held that the scope of the *res judicata* effect will depend on the express terms of the judgment. For example, if the judgment merely recites that the patent is “valid and enforceable in all respects,” it will be given *res judicata* effect only as to future claims involving the same accused products (*i.e.*, claim preclusion).

On the other hand, if the judgment clearly sets forth the alleged infringer’s intent to refrain from “participating in any action contesting the validity of the patents,” the judgment will bar any future validity challenge by the alleged infringer, even if the challenge involves a different product or method (*i.e.*, issue preclusion).

What, then, about other orders or agreements that terminate a patent infringement? Will a provision barring future patent challenges still be enforceable if it is not part of a judgment for the patentee? This issue arose in *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348 (Fed. Cir. 1988),

---

where the district court dismissed the action pursuant to a “settlement order” that had been signed by both the judge and the parties.

Although the order did not enter judgment for the patentee, it did provide that the “issues of validity, enforceability and infringement...are hereby finally concluded and disposed of.” The order further provided that the alleged infringer would honor the terms of a patent license agreement even if the patent was later invalidated in another proceeding.

On appeal, the Federal Circuit did not reach the question of whether a judicial order that affirmed the validity of a patent (but did not enter judgment for the patentee) should be given *res judicata* effect. Instead, the court relied solely on the “compelling public interest” in the enforcement of agreements that terminate litigation.

The court stressed that such agreements must be enforced in order to encourage parties to enter into them and thereby conserve resources and promote judicial economy. In light of this interest (which was wholly absent in *Lear*), the court held that the licensee’s promise to honor the terms of the patent license was enforceable.

The Federal Circuit applied the same logic in another case involving only a settlement agreement and dismissal order, rather than a consent judgment or a judicial decree. In *Flex-Foot Inc. v. CRP Inc.*, 238 F.3d 1362 (Fed. Cir. 2001), the patentee and the alleged infringer entered into a settlement agreement that provided for the dismissal of the litigation with prejudice.

As part of the agreement, the alleged infringer executed a patent license and pledged that it would not contest the validity of the patent in any future litigation. On these facts, the Federal Circuit held that the settlement agreement was not entitled to *res judicata* because the litigation did not result in a judicial determination against a party.

The court did find, however, that the agreement operated as contractual estoppel to bar any subsequent claim of invalidity. The court again stressed that if a patent license is part of a settlement agreement, it implicates the “compelling public interest” in terminating litigation and conserving scarce judicial resources.

Thus, under these authorities, the law gives more weight to the settlement of litigation than to *Lear*’s policy interest in the “free use of ideas.” Consequently, if a patent license is part of a settlement agreement, a licensee’s promise to refrain from any future patent challenge will be enforceable under principles of contractual estoppel and (in some cases) *res judicata*.

To obtain the maximum protections of *res judicata*, the agreement should require the entry of both a consent judgment and a permanent injunction that recite (among other things) the following: (1) the patents-in-suit are valid and enforceable in all respects; (2) the accused products infringe the patents-in-suit; (3) judgment is being entered in favor of the patent owner based on the infringement of the patents-in-suit; (4) the alleged infringer is enjoined from initiating or participating in any action or proceeding contesting

---

the validity or enforceability of the patents (no matter what the underlying product, method or process); and (5) the judgment is binding upon (and constitutes *res judicata* between) the parties and their successors and assigns.

To comply with the requirements of an injunction under federal law, such an order would have to specify the prohibited conduct, rather than simply incorporate by reference the license or other settlement documents. See Fed.R.Civ.P. 65(d).

The next best option is a settlement that requires the entry of a judicial order specifically affirming the validity, enforceability and infringement of the patents-in-suit. In such a case, the order should incorporate by reference both the underlying settlement agreement and the patent license, and (if possible) it should vest the court with jurisdiction over the enforcement of the agreements.

The order should also stipulate that the alleged infringer will not initiate or participate in any challenge to the patents-in-suit, or claim that the accused products do not infringe the patents.

Finally, the agreement should state that the alleged infringer's agreement to refrain from any future challenge to the patent is necessary consideration for the patent owner's agreement to terminate the litigation.

A third option is a settlement that results in the entry of a dismissal order vesting the court with jurisdiction over the enforcement of the parties' agreements. Such an order would dismiss the infringement allegations without prejudice so that the court could continue to exercise jurisdiction over the case.

In addition, the settlement agreement (and the license) should set forth the alleged infringer's contractual duty to refrain from any future challenge to the patents-in-suit. The agreement should also recite that this obligation is necessary consideration for the patent owner's agreement to terminate the litigation.

Finally, even if the court enters an order that simply dismisses the infringement action with prejudice, the patent owner will likely obtain adequate protection if the settlement agreement expressly sets forth the alleged infringer's pledge to refrain from any future challenge to the patents-in-suit. By linking this pledge to the termination of the litigation, the agreement will implicate the public interest underlying the *res judicata* doctrine, even if the doctrine itself is inapplicable.

Thus, while MedImmune creates new opportunities for licensees, a carefully-drafted patent license (or settlement agreement) can protect the patent owner's interest in reducing the incentives for future challenges to the patent.

--By James R. Ferguson, Mayer, Brown, Rowe & Maw LLP

James R. Ferguson is a partner in the Chicago office of Mayer, Brown, Rowe & Maw LLP, where he specializes in intellectual property litigation.

This article is for purposes of discussion only, and it should not be considered legal advice.