

# OPERATION RESTORATION: HOW CAN PATENT HOLDERS PROTECT THEMSELVES FROM MEDIMMUNE?

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## ABSTRACT

*The Supreme Court's recent decision in MedImmune v. Genentech shifts the balance of power in license agreements from patent holders to their licensees. This iBrief outlines the potential implications of the new rules on all stages of patent prosecution and protection. Further, it evaluates remedial contract provisions patent holders may include in future license agreements and how these provisions may mitigate the decision's effects on preexisting commercial relationships.*

## INTRODUCTION

¶1 On January 9, 2007, the Supreme Court supplied patent licensees with a new weapon for their arsenals with its holding in *MedImmune v. Genentech*.<sup>2</sup> In 1997, the petitioner, drug manufacturer MedImmune, entered into a license agreement with the respondent, patent holder Genentech, which covered Cabilly I, an existing patent, and Cabilly II, a pending patent application.<sup>3</sup> In 2001, Genentech attempted to instate royalty obligations on Cabilly II, which had then matured into a patent.<sup>4</sup> MedImmune sought declaratory relief but was denied standing under the Federal Circuit's requirement that "a licensee must, at a minimum, stop paying royalties . . . before bringing suit to challenge the validity or scope of the licensed patent."<sup>5</sup> On *writ of certiorari*, the Supreme Court ruled 8-1 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,

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<sup>2</sup> *MedImmune v. Genentech*, 127 S. Ct. 764 (2007).

<sup>3</sup> *Id.* at 767-68.

<sup>4</sup> *Id.*

<sup>5</sup> *Gen-Probe v. Vysis*, 359 F.3d 1376, 1381 (Fed. Cir. 2004).

unenforceable, or not infringed. The Court of Appeals erred in affirming the dismissal of this action for lack of subject-matter jurisdiction.<sup>6</sup>

¶2 The decision did not surprise those familiar with the Roberts Court's skepticism toward patent rights and, correspondingly, the Federal Circuit's formalistic efforts to protect those rights.<sup>7</sup> *MedImmune* could potentially "clear[] the way for timely challenges to junk patents that impede innovation," but the stability of patents and accessibility of licenses ultimately depends on the willingness of patent holders to license their rights and the likelihood that licensees will challenge those rights.<sup>8</sup> This iBrief identifies and evaluates potential strategies patent holders may use to offset the likelihood of declaratory judgment actions against their patent rights.

## I. THE NEW RULES OF PATENT LICENSING

### A. *The Supreme Court's Ruling*

¶3 Before *MedImmune*, patent holders and their licensees used licenses as a means to avoid litigation; in this respect, a license was analogous to a settlement agreement between parties seeking to preempt the threat of litigation.<sup>9</sup> A potential licensee "wanting to engage in conduct arguably

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<sup>6</sup> *MedImmune*, 127 S. Ct. at 777.

<sup>7</sup> See Lorelei Ritchie de Larena, *Re-evaluating Declaratory Judgment Jurisdiction in Intellectual Property Disputes*, 83 IND. L.J. 1, at 21 (2007); Greg Stohr, *Patent Case Creates Unusual Allies*, THE SEATTLE TIMES, Feb. 20, 2007, at C3 ("The way they have been trending the last few years . . . is removing the power from the patents . . . [T]he justices repeatedly slammed a test used by the Federal Circuit to limit patent challenges . . . Scalia called the test 'gobbledygook,' while Roberts said it was 'worse than meaningless.'"); *Supreme Court Rules on Case or Controversy Requirement in Patent Litigation*, TECH LAW JOURNAL, Jan. 1, 2007, <http://www.techlawjournal.com/home/newsbriefs/2007/01b.asp> (last visited Nov. 12, 2007) ("Yet again, the Supreme Court has thrown out a ruling that perpetuates dysfunctions in the patent system . . . [t]his marks yet another occasion where the Court has clamped down on the Federal Circuit's wayward jurisprudence.").

<sup>8</sup> *Supreme Court Rules on Case or Controversy Requirement in Patent Litigation*, *supra* note 7.

<sup>9</sup> See *MedImmune v. Centocor*, 409 F.3d 1376, 1379 (2005) ("[A] license is, by its nature, an agreement not to litigate. A licensor agrees to receive royalties or other consideration from the licensee in exchange for a covenant not to sue or disturb the licensee's activities."); Brief for The Trustees of Columbia University in the City of New York et al. as Amici Curiae Supporting Respondents at 10, *MedImmune v. Genentech*, 127 S. Ct. 764 (2007) (No. 05-608) [hereinafter *Columbia Brief*] ("Indeed, the very point of the agreement is to

covered by a patent” would enter into negotiations with the patent holder, wherein they would express their views regarding “whether the conduct is covered and whether the patent is a valid, enforceable one.”<sup>10</sup> The agreement seems beneficial for both parties: the licensee is free to use the patent without fearing an infringement suit, while the patentee profits from his invention without having to market it himself.<sup>11</sup> However, prior to *MedImmune*, a licensee seeking to challenge the licensed patent faced bleak options under the Federal Circuit’s standing requirement: continue paying royalties without challenging the patent, or breach the license agreement and risk an infringement suit. In these situations, licensees such as MedImmune, who lack the financial capital to cover the potential damages from an infringement suit, found themselves trapped into royalty payments.<sup>12</sup>

¶4 Now a licensee can bring an action against its licensor for a declaratory judgment of invalidity or noninfringement without breaking its license and risking an infringement suit.<sup>13</sup> In addition to the ability to protect itself from the risk of treble damages, licensees also gain the ability to preemptively engage the patent holder rather than having to respond to an infringement suit with an invalidity or noninfringement counterclaim.<sup>14</sup>

### *B. Issues for Lower Courts to Decide*

¶5 By answering only the question of whether a licensee is required, “insofar as Article III is concerned, to break or terminate its . . . license agreement before seeking a declaratory judgment in federal court that the underlying patent is invalid, unenforceable, or not infringed,”<sup>15</sup> the Court’s

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settle the dispute and to put the technology into practice without wasteful expenditures on judicial processes.”).

<sup>10</sup> Columbia Brief, *supra* note 9, at 10.

<sup>11</sup> *See id.* (“The licensee gets substantial benefits: the right to practice the patent free of litigation threat; the freedom to do so immediately without awaiting years of litigation; and a negotiated royalty rate reduced from the patentee’s initial offer to reflect any perceived uncertainty over issues of patent validity, enforceability, and coverage.”).

<sup>12</sup> MedImmune, for example, feared that if it breached the agreement it may be liable for “treble damage and attorney’s fees, and . . . more than 80 percent of its revenue.” *MedImmune*, 127 S. Ct. at 766.

<sup>13</sup> *Id.* at 774 n.11.

<sup>14</sup> Qin Shi, *Reexamination, Opposition, or Litigation? Legislative Efforts to Create a Post-Grant Patent Quality Control System*, 31 AIPLA Q. J. 433, 465 (2003).

<sup>15</sup> *MedImmune*, 127 S. Ct. at 777.

narrow holding in *MedImmune* may have “potentially raise[d] more issues than it resolve[d].”<sup>16</sup>

*1. Can licensees contractually reduce the risk of declaratory judgments?*

¶6 *MedImmune* leaves patent owners wondering whether or not they can contract around their potential vulnerability to patent challenges by inserting provisions in their license agreements that prohibit or deter licensees from raising those challenges. They “are likely to try a number of different strategies in . . . negotiations and in litigation until . . . the questions raised by *MedImmune* are resolved” by the lower courts.<sup>17</sup> These strategies and their potential likelihood of success are discussed further in Section II of this iBrief.

*2. Are licensees liable for royalty payments while challenges are pending?*

¶7 In *MedImmune*, the Court acknowledged the existence of the above question without expressing an opinion.<sup>18</sup> The Court noted previously that requiring licensees “to continue to pay royalties while challenging a patent’s validity in the courts” would undermine “the strong federal policy favoring the full and free use of ideas in the public domain.”<sup>19</sup> Even where a contract required “payment of royalties until the patent was shown to be invalid,” the Court allowed the licensee to avoid payment of “all royalties accruing after issuance of the patent” if the patent was found to be invalid.<sup>20</sup> While

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<sup>16</sup> George C. Best, *U.S. Supreme Court Decision Permits Patent Challenges by Licensees*, MONDAQ, Jan. 24, 2007, <http://www.mondaq.com/article.asp?articleid=45844>; see also Pete Yost, *Court Rules in Favor of MedImmune*, CBS NEWS, Jan. 9, 2007, <http://www.cbsnews.com/stories/2007/01/09/ap/business/mainD8MHSGPO1.shtml> (quoting George C. Best as saying *MedImmune* “opens the courthouse door and lets people come in and possibly allows them to challenge, but it also leaves many questions unanswered”).

<sup>17</sup> Charles S. Barquist and Jason A. Crotty, *MedImmune v. Genentech: The Supreme Court Opens the Federal Circuit’s Declaratory Judgment Jurisprudence*, U.S. SUPREME COURT MONITOR, Jan. 29, 2007, <http://www.law.com/jsp/scm/PubArticleSCM.jsp?id=1169806060399>.

<sup>18</sup> *MedImmune*, 127 S. Ct. at 775-76. Some commentators are confident, regardless, that *MedImmune* would indeed be liable for all royalty payments before the patent is found invalid or unenforceable. Josh Rosenkranz, Patricia Thayer, and Jeffrey Hsu, *MedImmune v. Genentech Ruling Creates Patent Licensing Uncertainty*, HELLER EHRMAN LLP, Jan. 29, 2007, [http://www.hewm.com/en/news/industry/industry\\_3427.html](http://www.hewm.com/en/news/industry/industry_3427.html) (“Under the prevailing case law, even if the issue of *Cabilly II*’s validity is decided on the merits on remand, *MedImmune* will not be entitled to recover any royalties paid before a final judgment of patent invalidity or unenforceability is rendered.”).

<sup>19</sup> *Lear, Inc. v. Adkins*, 395 U.S. 653, 673-74 (1969).

<sup>20</sup> *Id.* (emphasis added).

Supreme Court precedent seems to weigh against patent holders' ability to use license terms to enforce royalty payments throughout patent challenges, Section II addresses alternative ways patent holders can secure continued compensation in the face of a challenge.

### 3. *When is discretionary dismissal appropriate?*

¶8 Even though the Supreme Court ruled that *MedImmune* met all standing requirements, it left "equitable, prudential, and policy arguments in favor of such a discretionary dismissal for the lower courts' consideration on remand."<sup>21</sup> The Declaratory Judgment Act specifically entrusts courts with discretion on whether to hear declaratory suits.<sup>22</sup> Thus, when deciding whether to grant standing to royalty-paying licensees, lower courts will defer to a variety of indeterminate factors in evaluating "whether the investment of time and resources will be worthwhile."<sup>23</sup>

¶9 A court may consider, for example, the maturity of the subject patent when the license agreement was issued. Most likely, it would be less sympathetic toward the licensee who failed to take an opportunity to examine the licensed patent before entering the agreement than the licensee who lacked that opportunity.<sup>24</sup> A licensee challenging a patent that was still pending when the license was executed, like *MedImmune*, would fall into the latter category. Courts may be inclined to adjudicate such a case, given the indeterminate nature of the patent and the licensee's lack of opportunity to examine it before entering the agreement.<sup>25</sup>

## II. GETTING AROUND *MEDIIMMUNE*

¶10 Post-*MedImmune* license agreements are forecasted to include boilerplate provisions prohibiting licensees from challenging underlying patents, particularly because "the Supreme Court has now held that if the license agreement is silent on the subject, a licensee will be able to challenge the patent in federal court without breaching the license

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<sup>21</sup> Gregory Castanias, Douglas R. Cole & Stephen J. Goodman, *Another Change in U.S. Patent Law: U.S. Supreme Court Rules that Patent Licensees May Seek Declaratory Judgments in Patent-License Cases Without First Breaching the License*, MONDAQ, Jan. 31, 2007, <http://www.mondaq.com/article.asp?articleid=45940>.

<sup>22</sup> 28 U.S.C. § 2201 (2006).

<sup>23</sup> *Serco Services Co., v. Kelley Co.*, 51 F.3d 1037, 1217-18 (Fed. Cir. 1995).

<sup>24</sup> See *Columbia Brief*, *supra* note 9, at 29 ("For many licenses, the patent . . . is available for the public to examine . . . before the parties commence their license negotiations. The prospective licensee thus has the ability to study the patent's claims, including its validity and scope, and to obtain an opinion of counsel.").

<sup>25</sup> See *MedImmune v. Genentech*, 127 S. Ct. 764, 766 (2007).

agreement.”<sup>26</sup> However, whether any “specific language restricting the ability of [a] licensee to challenge the patent while still in good standing . . . would be *enforceable* remains to be seen.”<sup>27</sup> Thus, if courts are hesitant to enforce blanket prohibitions against licensee challenges, patent holders may instead try to “discourage licensees from challenging their patents without creating an outright ban on such a challenge.”<sup>28</sup>

### A. Possible Contract Provisions

#### 1. Prohibiting declaratory judgment actions

¶11 Patent owners may feel unduly restricted “if a licensee can sue for a declaratory judgment of invalidity on a patent they are licensing without actually breaching the licensing agreement to create [an] infringement.” Thus, a patent holder may include a provision in the license agreement that “in exchange for the grant of the license no lawsuit can be brought challenging the validity of the relevant patent.”<sup>29</sup> Under such a provision, a licensee’s challenge against the licensed patent amounts to a material breach

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<sup>26</sup> Russell S. Timm & Brian McQuillen, *Patent Licensee in Good Standing Can Challenge Patent Under Declaratory Judgment Act*, MONDAQ, Jan. 12, 2007, <http://www.mondaq.com/article.asp?articleid=45562&searchresults=1>; see also *MedImmune*, 127 S. Ct. at 776 (“[I]t is not clear where the prohibition against challenging the validity of the patents can be found . . . [and] the contract, properly interpreted, does not prevent it from challenging the patents . . . .”); Paul Maple, Rick Sanders and Justin McNaughton, *Patent Licensees Have Standing to Challenge the Validity of a Licensed Patent*, MONDAQ, Feb. 21, 2007, <http://www.mondaq.com/article.asp?articleid=46394> (“The practical effect and future enforceability of such a provision is unknown since the MedImmune license did not include this provision and the Supreme Court did not address this issue.”).

<sup>27</sup> Timm & McQuillen, *supra* note 26 (emphasis added); see also Richard B. Smith, *Licensees May Be Getting a New Legal Weapon*, GENETIC ENGINEERING NEWS, March 1, 2007, <http://www.genengnews.com/articles/chitem.aspx?aid=2018> (“The enforceability of such provisions, however, is still an open question in light of the strong public policy favoring patent challenges.”).

<sup>28</sup> Smith, *supra* note 27 (emphasis added); see also Castanias et al., *Another Change in U.S. Patent Law*, JONES DAY, Jan. 2007, [http://www.jonesday.com/pubs/pubs\\_detail.aspx?pubID=S3933](http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=S3933) (“If such provisions are enforceable, then patent owners . . . may consider including such provisions in their licensing agreements, thereby ensuring that licensees will not be able to take advantage of their immunity from an infringement suit while simultaneously pursuing invalidity challenges.”).

<sup>29</sup> A. Jose Cortina, *TechLaw: Is MedImmune a Licensing Minefield?*, WRAL LOCALTECHWIRE.COM, Jan. 31, 2007, [http://www.localtechwire.com/business/local\\_tech\\_wire/opinion/story/1184908](http://www.localtechwire.com/business/local_tech_wire/opinion/story/1184908).

and termination of the agreement, permitting the patent holder to bring its own infringement claim against the licensee.<sup>30</sup>

### 2. Prohibiting declaratory judgment actions in certain circumstances

¶12 An alternative to estopping licensees from challenging licensed patents at all stages of the license is prohibiting challenges by licensees only once they meet certain criteria. Examples of criteria listed by practitioners include “enjoying the benefits of the license for a certain period of time, or paying a cumulative amount of royalties, or introducing another patented product, or the patent is successfully asserted against a third party.”<sup>31</sup>

¶13 Without enforceable provisions protecting patent holders, licensees could, for instance, create improvements on the licensed patent and then challenge the original patent’s validity once those rights no longer hold any potential value. In this situation, the licensee not only supplants the original patent’s utility by patenting an improvement on the original, but also may be granted a refund on royalty payments made for the use of those rights. Thus, while the enforceability of this particular type of provision has yet to be addressed post-*MedImmune*, courts may consider enforcing such provisions to prevent licensees from abusing their new *MedImmune* power.

### 3. Increasing royalty rates upon declaratory judgment actions

¶14 It is possible that a provision imposing increased royalties on a licensee exercising its right to challenge a patent may be enforced when the pre-filing rate could be considered a discount reflecting the uncertainty of the patent’s validity—in accordance with the understood functioning of patent licenses.<sup>32</sup> However, if the variance in rates is too great, a court may

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<sup>30</sup> Peter Kaplan, *U.S. High Court Reinstates MedImmune Patent Suit*, REUTERS, Jan. 9, 2007, <http://www.reuters.com/article/companyNewsAndPR/idUSN0948092720070109> (suggesting *MedImmune* “could prompt patent owners to put conditions in their licenses that trigger immediate termination when a patent’s validity is challenged”).

<sup>31</sup> Michael D. McCoy, Kevin A. O’Brien & George M. Taulbee, *Supreme Court Eases Bar for Licensees to Challenge Licensed Patents: So . . . What Do You Do as a Licensee? Licensor?*, ALSTON + BIRD LLP, Jan. 31, 2007, <http://www.alston.com/files/Publication/09a368d1-e0c4-4763-8e60-21c20e4d30e2/Presentation/PublicationAttachment/b1da8282-9414-4262-a0aa-caf4af5ab3dd/MedImmune%20Advisory.pdf>.

<sup>32</sup> Clarisa Long, *MedImmune v. Genentech: What’s Left Standing?*, Speech at Duke University School of Law’s Sixth Annual Hot Topics in Intellectual Property Law Symposium (Feb. 23, 2007) (recording on file with the Duke Law and Technology Review); see also *supra* text accompanying notes 7-8.

view the post-filing rate as a penalty on licensees for exercising their Declaratory Judgment Act rights.<sup>33</sup>

¶15 Furthermore, while the Supreme Court was hesitant to enforce explicit requirements imposing royalty obligations on licensees throughout the course of litigation,<sup>34</sup> future license agreements could experiment with creative methods of exacting royalty payments. For example, patent holders could incorporate provisions prohibiting licensees from paying royalty payments under protest, making it more difficult for licensees to recover those payments.

¶16 Instead of *punishing* licensees for challenging patents, patent holders could *reward* licensees for refraining from challenging patents. One method patent holders could use to issue rewards would be to place a portion of each royalty payment into a litigation fund accumulating throughout the term of the license. The fund is available for patent holders to defend themselves against licensees' challenges, but if at the end of the license term no challenges have been raised, the entirety of the fund is returned to the licensee.

#### *4. Imposing procedural impediments to declaratory judgment actions*

¶17 Procedural impediments available to patent holders for deterring licensee challenges include mandatory arbitration, holding the licensee responsible for payment of associated legal costs, or establishing the licensor's freedom to bring the action in a licensor-favorable forum.<sup>35</sup> Even if these provisions are not effective in deterring challenges, they will reduce the burden on patent holders forced to defend their patent rights.

#### *B. Arguments For and Against Enforceability*

¶18 Acknowledging the underlying policy arguments that often govern enforceability of the contractual provisions described above, Justice Souter called the issue "a question of line drawing under Article III."<sup>36</sup> Where the courts decide to draw the line will be critical to the terms of future license

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<sup>33</sup> Long, *supra* note 32, *see also supra* text accompanying notes 7-8.

<sup>34</sup> *See Lear, Inc. v. Adkins*, 395 U.S. 653, 673 (1969).

<sup>35</sup> Lawrence M. Sung, *License to Sue? The Availability of Declaratory Judgment Actions to Patent Licensees After MedImmune, Inc. v. Genentech, Inc.*, INTELL. PROP. TODAY, Jan. 2007, <http://www.iptoday.com/pdf/2007/1/Sung-Jan2007.pdf>.

<sup>36</sup> *High Court Hears Arguments in Dispute over Licensees' Rights to Challenge Patents*, 14-10 MEALEY'S LITIG. REP: PATENTS 1, 2 (2006) [hereinafter *High Court*] ("And your argument is you want to draw the line, the way you want it drawn, primarily because there are practical reasons to favor a public policy of free challenge.").

agreements and to the conduct of licensing patent holders and their licensees.

¶19 Some commentators believe “federal patent law should not preempt operative contracts,” on the basis that preemption “adversely affect[s] patent licensing, which fosters competition and economic growth and efficiency by making technology and intellectual property more widely available.”<sup>37</sup> Accordingly, commentators speculated that certain license provisions prohibiting licensees from raising challenges may be invalidated on antitrust grounds.<sup>38</sup>

¶20 With respect to provisions completely prohibiting validity challenges, the Court held that “*Lear* does not prevent the[ir] enforceability . . . where that promise is made in connection with settling pending litigation involving the patent.”<sup>39</sup> However, when the Court considered whether it should grant *MedImmune* standing, it expressed concern that, “even if [we] granted permission to sue, Genentech would insist *MedImmune* sign away the right in order to keep the license . . . .”<sup>40</sup>

¶21 Pessimism about the prospect of courts enforcing this type of provision stems from the notion that, “[w]ith the growing tensions about patents in society, . . . such provisions could result in antitrust or public policy challenges and the establishment of further Supreme Court precedent.”<sup>41</sup> Justice Kennedy himself acknowledged that even if prohibitory language was given recognition, “we may not be talking about

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<sup>37</sup> Columbia Brief, *supra* note 9, at 19; *see also* Neil M. Goodman, *Patent Licensee Standing and the Declaratory Judgment Act*, 83 COLUM. L. REV. 186, 206 (Jan. 1983) (“If current licensees are allowed to bring offensive patent validity challenges, the patent system may be injured. Injury to the patent system may in turn harm our long-standing policy of promoting invention, and may ultimately reduce both competition and technological advance.”).

<sup>38</sup> Raymond Van Dyke, *Supreme Court Signals Balance Shift in Licensing Patents*, E-COMMERCE TIMES, Jan. 10, 2007, <http://www.ecommercetimes.com/story/55085.html>.

<sup>39</sup> Castanias et al., *supra* note 21; *but see* Sung, *supra* note 35 (explaining that contract provisions seeking to deter licensee challenges will be “subject to the *Lear v. Adkins* prohibition against estopping patent licensees from raising invalidity contentions”).

<sup>40</sup> *MedImmune Wants to Sue; Asks Supreme Court for Permission even Though it Is up to Date on License Payments*, 25 BIOTECHNOLOGY L. REP. 685, 685 (Dec. 2006).

<sup>41</sup> *See* Cortina, *supra* note 29 (“[W]hile the Courts of the United States have traditionally favored private agreements between parties as a way of avoiding litigation, such a suggestion seems to fly in the face of [a] policy . . . [of] avoidance of limitations on the ability to challenge a patent’s validity.”).

much. It's just going to be boilerplate in every license agreement, and that's the end of it."<sup>42</sup>

¶22 However, courts could still enforce these provisions. If they do, it is possible that *MedImmune* will hardly have any impact on license agreements; “the issue here may be mooted . . . as companies rewrite their agreements to handle licensee patent challenges.”<sup>43</sup> Widespread enforcement could also forestall *MedImmune*’s effects on litigation, particularly the projected increase in patent litigation.<sup>44</sup>

### III. POTENTIAL IMPLICATIONS

¶23 Current and potential parties to license agreements have large stakes riding on courts’ decisions regarding the enforceability of various contract provisions. This Section addresses the potential impact of the lower courts’ decisions regarding enforceability on “the relationship between licensors and licensees, the willingness of companies to enter into licenses and the way licenses are written.”<sup>45</sup>

#### A. Patent Applications

¶24 *MedImmune* may have “creat[ed] a federal court mechanism for what essentially amounts to a post-grant opposition to an issued patent by a competitor with the benefit of access to the patented technology but without the fear of reprisal for challenging the patent” with its decision in *MedImmune*.<sup>46</sup> Given that “[l]icensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor’s discovery,” the power to challenge a patent’s validity becomes particularly detrimental to patent holders when put in the hands of their licensees.<sup>47</sup>

¶25 Thus, if courts find provisions prohibiting patent challenges largely unenforceable, effectively clearing the path for licensees to challenge

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<sup>42</sup> Transcript of Oral Argument at 5, *MedImmune v. Genentech*, 127 S. Ct. 764 (2007) (No. 05-608), Oct. 4, 2007, *quoted in High Court, supra* note 36.

<sup>43</sup> *Van Dyke, supra* note 38.

<sup>44</sup> See Walter Hanchuk & Thomas E. Riley, *Supreme Court Decision Allows a Patent Licensee to Dispute the Patent and Seek a DJ Without First Breaching the Patent License*, MONDAQ, Feb. 12, 2007, <http://www.mondaq.com/article.asp?articleid=46002> (“Others, however, have suggested that the Supreme Court decision implies that a contractual prohibition against challenging the validity of a patent may effectively prevent a licensee from bringing a DJ action.”).

<sup>45</sup> *High Court, supra* note 36, at 1.

<sup>46</sup> *Sung, supra* note 35.

<sup>47</sup> *MedImmune v. Genentech*, 2004 U.S. Dist. LEXIS 28678 at \*16-17 (C.D. Cal. Apr. 23, 2004) (citing *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969)).

patents, *MedImmune* may have created a powerful judicial mechanism for challenging patents. Shifting some power from the United States Patent and Trademark Office (the “PTO”) to the federal courts may create a healthy rivalry between the PTO and the courts, which could generally improve patent quality.<sup>48</sup> Whereas many corporations previously sacrificed quality for quantity by obtaining patents in bulk, this imminent threat of declaratory judgment suits may now push them to invest in higher quality patents.<sup>49</sup>

### B. Patent Licenses

¶26 Patent holders always had to balance stating their patent rights affirmatively (in order to encourage others to license their patents) without being too aggressive (in order to avoid declaratory judgments). *MedImmune* robs patent holders of their ability to bargain for immunity from declaratory judgments through licensing and may beget “fewer licenses and more challenges to patents [since] the patent owner has his hands tied behind his back.”<sup>50</sup>

¶27 *MedImmune* “turns all fundamental assumptions about the stability and finality of a patent license completely on their head,” and since license terms are decided almost entirely through negotiations, those assumptions could completely transform the licensing arena.<sup>51</sup> This Section describes the considerations facing patent holders as they determine whether or not they should license their rights, and if so, the terms they should seek to impose in the agreement.

#### 1. Availability

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<sup>48</sup> See Long, *supra* note 32 (pointing to the desirability of encouraging rivalry between the courts and the PTO). Citing the escalations in the number of patents granted per year and an assortment of theories regarding the PTO’s flawed system, patent scholars have long expressed their desire for additional venues for patent challenges. See Stuart Minor Benjamin and Arti K. Rai, *Who’s Afraid of the APA? What the Patent System Can Learn from Administrative Law*, 95 GEO. L.J. 269, 316-17, Jan. 2007 (discussing deficiencies in the structure of the Patent and Trademark Office). However, other commentators speculate that the potential new mechanism is an “unintended consequence” of the decision and may “warrant legislative consideration and response.” Sung, *supra* note 35.

<sup>49</sup> Long, *supra* note 32.

<sup>50</sup> Marcia Coyle, *High Court Patent Case May Have Profound Business Impact*, THE NATIONAL LAW JOURNAL, October 3, 2006, available at <http://www.law.com/jsp/article.jsp?id=1159792526842> (last visited Nov. 9, 2007).

<sup>51</sup> *Having it Both Ways*, THE PATENT PROSPECTOR, Jan. 9, 2007, [http://www.patenthawk.com/blog/2007/01/having\\_it\\_both\\_ways\\_1.html](http://www.patenthawk.com/blog/2007/01/having_it_both_ways_1.html).

¶28 While “[l]icensees may be more willing to enter into patent licenses, since doing so will not limit their ability to challenge a licensed patent,” patent holders, having lost “the quid pro quo in the arrangement,” will probably be less willing, especially if contractual prohibitions or deterrents to challenges are not upheld.<sup>52</sup>

¶29 Since the Court’s decision supplies licensees, not *potential* licensees, with leverage, patent holders may try to preserve their abilities to bring infringement claims and to shield themselves from declaratory judgment actions by simply not licensing their rights. Corporations with substantial patent rights may want to avoid licensee challenges by integrating vertically instead of extending licenses to competitors. Non-commercial enterprises, such as research universities, may also refrain from licensing if they do not have the financial resources to cover their potential litigation costs.<sup>53</sup>

¶30 A decrease in the number of licenses will ultimately hinder innovation, which requires disaggregation and licensing.<sup>54</sup> Moreover, vertical integration often prevents products from reaching the market.<sup>55</sup> Even more, non-commercial enterprises rely on licensees “to make their useful, patented inventions available to the public,” so their resistance to licensing “could remove many important technological inventions from public availability.”<sup>56</sup>

## 2. Royalty Rates

¶31 Royalty rates in pre-*MedImmune* licenses generally “reflect[ed] assessments of likely litigation outcomes: *more* than if the *licensee* were to prevail in court; *less* than if the *patentee* were to prevail in court.”<sup>57</sup> Royalty rates could increase if courts prevent patent holders from using licenses to protect themselves from declaratory judgment suits because, without the ability to use the license as protection, there is no incentive to

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<sup>52</sup> Barquist and Crotty, *supra* note 17; Van Dyke, *supra* note 38; *see also* Richard A. Epstein, *Patent’s Downward Spiral*, THE FINANCIAL TIMES, July 19, 2006, <http://www.ft.com/cms/s/2/09a2a554-1720-11db-abad-0000779e2340.html>.

<sup>53</sup> Columbia Brief, *supra* note 9, at 20; Long, *supra* note 32.

<sup>54</sup> Long, *supra* note 32.

<sup>55</sup> *Id.*

<sup>56</sup> Robin M. Davis and Khara Ashlynn Tusa, *Patent, Declaratory Judgment, Licensee Estoppel, Justiciable, Breach of License Agreement*, CORNELL LEGAL INFORMATION INSTITUTE, <http://www.law.cornell.edu/supct/cert/05-608.html> (last visited Nov. 9, 2007).

<sup>57</sup> *Id.* (emphasis added).

discount royalty rates.<sup>58</sup> If, however, patent holders can contractually prevent licensee challenges, the licensees' newfound power may serve as an "added arrow in their quivers to use in the negotiation process."<sup>59</sup> Patent holders may then continue, as they did before *MedImmune*, to discount royalty rates to "try to reduce the likelihood of a challenge."<sup>60</sup>

¶32 Licensees paying extortionate royalty rates have a greater economic incentive to challenge the underlying patents than those paying reasonable or discounted rates. However, since treble damages are a function of royalty rates, those same licensees also have the potential to lose more if the patent holder prevails.<sup>61</sup> Thus, commentators do not agree about whether royalty rates will collectively increase or decrease. The rate may depend on the function of the likelihood the licensee will challenge the patent and the likelihood of the licensee prevailing in such a challenge.

¶33 *MedImmune* might also alter payment structures of royalties. Most commentators believe that patent holders will require payments in lump sum and upfront, rather than incrementally spread out over the entire term of the patent, due to their growing wariness toward their licensees.<sup>62</sup> This

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<sup>58</sup> See Barquist and Crotty, *supra* note 17 ("MedImmune may cause licensors to demand higher royalties because the incentive to compromise is reduced if the licensor knows that the license is not a final resolution, but rather that the licensee can simply turn around and file a declaratory judgment action challenging the validity of the patent or whether it is used, or infringed, at all."); *Is anything ever final?* *MedImmune v. Genentech*, PATENT MONKEY, Jan. 10, 2007, <http://www.patentmonkey.com/PM/IMTBlog/tabid/63/EntryID/17/Default.aspx> ("Patent holders demand higher royalties as a means to imbed the costs of future challenges.").

<sup>59</sup> George R. McGuire, *New Arrow for Licensees' Quivers—Supreme Court Changes Balance of Power with Licensors*, BOND, SCHOENECK & KING, PLLC, Jan. 2007, <http://www.bsk.com/archives/infomemo.dbm?StoryID=787>; see Bill Warren, Ann G. Fort and Kathryn H. Wade, *U.S. Supreme Court Facilitates Ability to Challenge Patent Validity*, MONDAQ, Jan. 23, 2007, <http://www.mondaq.com/article.asp?articleid=45718> ("Licensees will use their new power as a means to renegotiate more favorable license terms.").

<sup>60</sup> Stephen Albainy-Jenei, *Supreme Court High-Fives MedImmune*, PATENT BARISTAS, Jan. 10, 2007, <http://patentbaristas.com/archives/2007/01/10/supreme-court-high-fives-medimmune>.

<sup>61</sup> See 35 U.S.C. § 284 (2006) ("Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court . . . . [T]he court may increase the damages up to three times the amount found or assessed.").

<sup>62</sup> Long, *supra* note 32; see also Cortina, *supra* note 29 ("[L]icensors can avoid problems by refusing to enter into agreements requiring running royalties and

could hinder the growth of small companies that are unable to procure large fees in their early development stages.<sup>63</sup> Also, since many useful technologies are licensed by universities for relatively small financial returns, the prospect of expensive patent litigation could raise the cost of making these inventions available to the public.<sup>64</sup>

### C. Patent Litigation

¶34 Before *MedImmune*, patent licensees were required to break their agreements before they were allowed to challenge underlying patents; they generally were hesitant to bring challenges to avoid being sued by the patent holder.<sup>65</sup> *MedImmune* gives licensees the gifts of preemptive engagement and forum selection, and the advantage of “steer[ing] the course of litigation and concurrent out-of-court business negotiations.”<sup>66</sup> This “procedural ability after *MedImmune* of a licensee to avail itself of a declaratory judgment suit in an advantageous forum [could trigger] an increased incidence of licensee challenges on presently licensed patents.”<sup>67</sup>

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instead require a lump sum payment based on net present value of a running royalty.”); Sung, *supra* note 35 (“[L]icensors in the post-*MedImmune* era might be encouraged to seek lump-sum, paid-up or other front-loaded royalties.”).

<sup>63</sup> Cortina, *supra* note 29 (“This would . . . prevent many small companies from being able to enter into license agreements because of a lack of resources to pay large up-front fees.”).

<sup>64</sup> Columbia Brief, *supra* note 9, at 20.

<sup>65</sup> Steve Johnson, *Genentech Loses Patent Dispute with MedImmune*, MERCURY NEWS, Feb. 21, 2007, [http://www.mercurynews.com/search/cj\\_5279391](http://www.mercurynews.com/search/cj_5279391).

<sup>66</sup> *Id.*; *see id.* at 465-66 (“[A] competitor or alleged infringer is much more likely to win when it selects the forum . . . The patentee wins 58% of the claims when it selects the forum by suing for infringement but only 44% when the competitor selects the forum by filing a declaratory judgment action.”).

<sup>67</sup> Sung, *supra* note 35; *see also* McGuire, *supra* note 59 (noting that *MedImmune* is “certain to spark a rise in suits being filed by licensees who believe they are being coerced into paying royalties”). Patent holders also may be more inclined to seek final judgments of patent validity through litigation, since they would be less likely to settle their potential grievances with competitors through licenses. Van Dyke, *supra* note 38. Prospective licensors may even feel compelled, before entering into a license, to file suit against the potential licensee and propose the license as a settlement that would then have *res judicata* effect. Commentators have predicted a rise in “so-called friendly lawsuits between a licensor and licensee, where a patent holder brings a suit against a licensee with the consent of the licensee. *Id.*; *see also* Benjamin and Rai, *supra* note 48, at 328 (discussing the rigorous examination process as an alternative venue for patent holders seeking validation). Commentators, particularly Genentech’s supporters, have voiced their concern about the waste of judicial resources these “friendly lawsuits” would promote. Columbia Brief, *supra* note 9, at 29. The purpose here would be to validate the licensed patent by

¶35 Furthermore, before *MedImmune*, a licensee raising a challenge to a patent that was part of a multi-patent license agreement would have to risk the entire license to challenge even one of the patents.<sup>68</sup> Now these licensees can come forth and challenge those individual patents while still preserving their entire agreement.

### CONCLUSION

¶36 The new twist in patent licensing and litigation that *MedImmune* provoked will certainly have a tangible effect on the number and substance of courtroom proceedings. However, given the number of open questions yet to be decided by the courts and the variety of factors involved, the exact form and degree of the effect is uncertain. Even more unpredictable is the future of patent license agreements as they respond to the new federal standing requirement. The availability and terms of license agreements will depend on their respective value to each party. Their values will likely be governed by the enforceability of provisions attempting to restore the pre-*MedImmune* licensing environment.

¶37 Aside from its effect on patent licenses, the variety of amicus curiae supporting both sides of the case reveals that *MedImmune*'s impact will reach far beyond the patent world; the decision has already been cited in several non-IP cases as a basis for granting standing to plaintiffs seeking declaratory relief.<sup>69</sup> With its decision in *MedImmune*, the Court is keeping

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a judgment, "thereby strengthening the patent against subsequent invalidity assertions by others." Van Dyke, *supra* note 38.

<sup>68</sup> Barquist & Crotty, *supra* note 17. It is speculated that owners of biotechnology patents may face a greater risk of declaratory judgment actions, "since they are particularly vulnerable to written description and enablement challenges under 35 U.S.C. §112." *Id.*

<sup>69</sup> *MedImmune* has been cited in favor of plaintiffs challenging an insurance claim, *Firemen's Ins. Co. v. Kline & Son Cement Repair, Inc.*, 2007 U.S. Dist. LEXIS 12609 at \*11-12 (E.D. Va. Feb. 12, 2007), an employee medical treatment act, *BNSF Railway Company v. Charles E. Box*, 2007 U.S. Dist. LEXIS 3563 at \*24 (C.D. Ill. 2007), and a sexual predator punishment act, *Doe v. Schwarzenegger*, 2007 U.S. Dist. LEXIS 12352 at \*14 n.8 (D. Cal. 2007); Coyle, *supra* note 36 ("The high stakes are reflected by the amicus parties in the case. The Bush administration, generic drug makers, and environmental groups who believe the decision could have impact beyond the patent field, are among those supporting *MedImmune*."). See Barquist & Crotty, *supra* note 17 ("The *MedImmune* decision will have an impact not only on the law regarding declaratory judgment actions by licensees, but also on the Federal Circuit's declaratory judgment jurisprudence generally."); Hanchuk & Riley, *supra* note 44 ("Some have also suggested that the instant decision may affect the ability to dispute various non IP-related contracts."). Nonetheless, other courts confronted with *MedImmune* avoided addressing the question. See, e.g., *Hydril Co. v.*

patent holders anxiously anticipating the courts' determination of what, if any, measures they can take to protect their patents from challenges. Given the high stakes, it should not be long until courts are faced with disputes over post-*MedImmune* license agreements and patent holders will be more assured about the scope of their abilities to contract around *MedImmune*.

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Grant Prideco LP, 474 F.3d 1344 (Fed. Cir. 2007) (disclaiming the need to address *MedImmune*); WS Packaging Group v. Global Commerce Group, LLC, 2007 U.S. Dist. LEXIS 5187 at \*8 n.3 (E.D. Wis. Jan. 24, 2007) (leaving the decision of whether or not to reexamine the declaratory judgment standard to the discretion of the Federal Circuit).