Intellectual Property

Supreme Court Justices Halt Federal Circuit Advance on *Lear v. Adkins*

*By David E. Foster**

The Supreme Court recently put an end to Federal Circuit efforts to revive a doctrine that prohibits patent licensees from challenging the validity of patents they have licensed. Although this doctrine of "licensee estoppel" had been in something of a coma since the 1969 Supreme Court decision in *Lear v. Adkins*, it appeared that the Federal Circuit's revival efforts might nurse it back to health.[1] Whether the Supreme Court's recent decision in *MedImmune v. Genentech* is a temporary setback for the doctrine, or a binding "Do Not Resuscitate" order, remains to be seen.[2]

Landmark Cases

Lear v. Adkins

Prior to 1969, courts interpreted the common law of contracts as preventing a patent licensee from challenging the validity of a licensed patent under the doctrine of licensee estoppel. In *Lear v. Adkins*,[3] the plaintiff Lear had agreed to pay royalties for a license to use Adkins's gyroscope technology at a time when Adkins's patent application was still pending before the U.S. Patent and Trademark Office (PTO).[4] While the patent application was still pending, Lear ceased paying royalties to Adkins, though continued to produce the licensed gyroscopes. Once the patent issued, Adkins brought suit against Lear for breach of the license agreement. In defense, Lear sought to obtain a judgment that Adkins's patent was invalid.[5] The district court, however, directed a verdict in favor of Adkins, holding that Lear was estopped by the license agreement from contesting the patent's validity. The case was appealed all the way up to the United States Supreme Court.

The Supreme Court ruled that "the federal law of patents" trumps "the common law of contracts" and abrogated the doctrine of patent licensee estoppel.[6] The *Lear* Court stated that contract law "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."[7] The Court identified a strong patent policy in favor of the elimination of invalid patents, and argued that licensees are often in the best position, and have the most incentive, to challenge the validity of a questionable patent.

The Constitution provides that Congress shall have the power to "promote the Progress of Science and the useful Arts, by securing for limited Times to . . . *Inventors* the exclusive right to their respective . . . Discoveries."[8] Congress has, for patent purposes, defined "inventors" as those who create inventions that are new, useful, and non-obvious.[9] Even if the Patent Office issues a patent, if a court later determines that the claimed invention is old, not useful, or obvious in view of the prior art, the patent is invalidated and the invention enters the public domain. The original patent applicant is no longer considered the "inventor" of the technology for patent purposes, and is no longer able to exclude others from using the technology or collecting royalties for its use. Even though in such a case the patent never should have issued, the former patent holder is also not required to return any license fees, royalties, or patent damages collected before the invalidity ruling, except perhaps in extreme cases rising to the level of fraud or patent misuse.

The *Lear* Court held a skepticism of patent grants and their potential effects on competition. Their decision expressed the view that invalidating improperly granted patents was a public good. Not only did the licensee in *Lear* benefit from the ability to challenge the patent, but once invalidated, other competitors in the marketplace would be able to practice the invention without having to pay a toll to the owner of an improperly granted patent. While Adkins would no longer have an extra incentive to invest in his technology, Lear's freedom from royalty obligations, together with potential new entrants to the market whose products could not be enjoined by Adkins, would have the effect of increasing competition and reducing prices to consumers.

C.R. Bard

The year after it was established, the Federal Circuit applied the patent policies expressed in *Lear* by holding that federal courts do have jurisdiction over a licensee's validity challenge, even when the license is still in effect.[10] In *C.R. Bard Inc. v. Schwartz*, the licensee had stopped paying royalties and the licensor sued in state court for royalties owed. The licensee responded by filing a declaratory judgment action in federal court. The appellate court held that, rather than a bright line rule requiring "termination of a license as a precondition to suit. . . . an examination of the totality of the circumstances must be made to determine whether there is a controversy arising under the patent laws."[11] According to that court, a bright line rule "would discourage licensees from contesting patent validity and would be contrary to the policies expressed in *Lear*."[12] It is worth noting, however, that in this case the licensee had stopped paying royalties, so that the licensor was the party in control of whether or not the license was terminated.

Shell Oil

By 1997, however, the Federal Circuit appeared to have changed its opinion of the patent policies expressed in *Lear*, and was working hard to limit its further application. The Federal Circuit no longer viewed patent validity challenges as a positive activity that courts should discourage validity challenges, favoring a perceived certainty and stability of patents and patent licenses. While officially acknowledging the supremacy of the Supreme Court, the Federal Circuit worked effectively to overrule the *Lear* decision by severely restricting its application.

** David E. Foster is Intellectual Property Counsel at Actel Corporation and serves on the Intellectual Property Practice Group. His views are his own, and do not necessarily reflect those of his employer.*

This is most prominently evident in *Studiengesellschaft Kohle M.B.H. vs. Shell Oil Co.*[13]

The *Shell Oil* decision seemingly purports to limit the rule established by the Supreme Court in *Lear* by superimposing on *Lear* a two-part test. In *Shell Oil*, the licensee had agreed to pay royalties for use of the licensor's patented process for producing a plastic (polypropylene) using a specific process. During the term of the license, the licensee began also to produce polypropylene using a second process that it did not disclose to the licensor, as required under the license agreement. The licensee failed to pay royalties on sales of polypropylene using the second process, even though it continued to pay royalties for its continued use of the first process. When the licensor ultimately discovered the licensee's second process, it brought suit to enforce the license agreement against the second process as well, and the licensee sought to challenge the validity of the patent claims as interpreted to read on the second process.

The Federal Circuit, departing from *Lear*, held that "a licensee . . . cannot invoke the protection of the Lear doctrine until it (i) actually ceases payment of royalties, and (ii) provides notice to the licensor that the reason for ceasing payment of royalties is because it has deemed the relevant claims to be invalid."[14] In other words, a licensee must breach its license agreement, advise the licensor of the reason for the breach, and subject itself to a claim for infringement damages and a potential permanent injunction in order to challenge the validity of the licensed patent. The Federal Circuit required the licensee to entirely give up its right to practice the first process in order to challenge the licensor's interpretation of the patent claims to cover the second process.

Gen-Probe

In *Gen-Probe Inc. v. Vysis, Inc*., the Federal Circuit was faced with the choice of extending either *C.R. Bard* or *Shell Oil* to a new situation.[15] In keeping with its trend of constraining the application of *Lear*, the court extended *Shell Oil*.

Gen-Probe was perhaps a less sympathetic licensee than those in previous cases. The company licensed an issued patent on blood screening technology from Vysis as part of the settlement of an unrelated patent litigation. Gen-Probe then exercised an option to extend the license to its third-party allies in the assay market. Six months after obtaining the license, Gen-Probe filed a declaratory judgment action of non-infringement and invalidity, while maintaining that it would continue to pay royalties in order to remain in good standing under the license agreement until the claims of Vysis's patent were invalidated. The *Gen-Probe* court, while acknowledging the "totality of the circumstances" test in *C.R. Bard*, did not expressly apply the test, instead creating (although perhaps not explicitly) a bright-line rule that there is never a claim or controversy (and therefore no jurisdiction) in a declaratory judgment action for invalidity brought by a licensee who continues to pay royalties.

The MedImmune Case

In 1997, MedImmune and Genentech entered into a license agreement. At that time, Genentech owned a patent (Cabilly I) covering a use of cell cultures to manufacture human antibodies. It also had a pending continuation application based on the Cabilly application that would eventually issue as a patent in 2001 (the Cabilly II patent).[16] Under the 1997 agreement, Genentech licensed the Cabilly I patent (including the then-pending Cabilly II application) to MedImmune. The agreement stated that MedImmune would pay royalties on any product that fell under any licensed patent claim that had not expired or been held invalid.

When the Cabilly II patent finally issued, Genentech asserted that, under the license agreement, MedImmune owed royalties on the new patent for sales of its Synagis product that (presumably) did not infringe Cabilly I. This product represented 80% of MedImmune's sales. MedImmune believed the new patent was invalid, but paid the demanded royalties ("under protest") in order to avoid a potential injunction and damages. MedImmune then sued for a declaratory judgment of invalidity of the second patent.

Both the district and appellate court decisions in *MedImmune* were relatively straightforward applications of *Gen-Probe*. The Federal Circuit decision[17] summarized the district court's opinion[18] as follows: "The district court, applying *Gen-Probe*, dismissed [MedImmune's] suit as non-justiciable under the Declaratory Judgment Act"[19] holding that "MedImmune, as a licensee in good standing and not in reasonable apprehension of suit, cannot bring a declaratory action to challenge the patent under which it is licensed."[20] The Federal Circuit agreed with the district court's reasoning that MedImmune would have to breach the license agreement and subject itself to a patent infringement suit (and possible injunction excluding its product from the market) in order to create a controversy that would give rise to a declaratory judgment action. Although it is not clear that MedImmune argued the point, the Federal Circuit did not address a major difference between this case and *Gen-Probe*: the Cabilly II patent did not issue until *after* MedImmune had signed the license, while the patent involved in *Gen-Probe* issued before Gen-Probe signed its license. If the Federal Circuit had been applying a "totality of the circumstances" test, rather than a bright line rule, one would expect this point to have been addressed.

In the Supreme Court, the case continued to be argued on purely jurisdictional grounds. MedImmune and the United States as amicus curiae argued that Genentech's demand for royalty payments on MedImmune's Synagis product (asserted very soon after the issuance of the Cabilly II patent), together with MedImmune's statements that it was paying the royalties "under protest" created a "case of actual controversy" under the Declaratory Judgment Act.[21] Supporting this position, MedImmune argued that (1) neither the Constitution nor the Declaratory Judgment Act require an actual violation of a statute in order to challenge the statute in court; and (2) federal patent policy encourages and protects challenges to patent validity. Genentech countered that the Declaratory Judgment Act does not allow a party to obtain judicial advice on what would happen if it repudiated a contract, and that Article III of the Constitution forbids courts from taking such a case where there is no controversy.

In an 8-1 decision (Thomas dissenting) the Supreme Court reversed and remanded to the lower courts for further

review.[22] The Court held that MedImmune did not have to breach the license agreement in order for its validity challenge to be an actual controversy that could be addressed in court. The Supreme Court reasoned that MedImmune had alleged a legitimate contract dispute: Was it required to pay royalties under the Cabilly II patent, or did it not owe royalties because the patent was invalid and un-infringed by the Synagis product? The Supreme Court has previously ruled that declaratory judgment jurisdiction exists in other contexts where the plaintiff's self-avoidance of imminent injury is coerced by threatened (rather than actual) enforcement action, and the *MedImmune* court decided that the patent context should be treated no differently.[23]

The Court also found it important that the consequences of the threatened enforcement action by Genentech would be significant for MedImmune (80% of its business was at risk of being assessed royalties). The Court was unconvinced by Genentech's argument that MedImmune had waived any right to challenge the patent's validity, stating: "Promising to pay royalties on patents that have not been held invalid does not amount to a promise *not to seek* a holding of their invalidity."[24] The Court found that MedImmune was not repudiating the contract while continuing to reap its benefits; rather, it was asserting that a proper interpretation of the contract does not require payment of royalties on invalid patents and does not prohibit it from challenging the validity of the patents.

The *MedImmune* decision did not specifically address the tension between the *C.R. Bard* "totality of the circumstances" test and the *Gen-Probe* bright-line rule. Rather, it seems to have established a bright-line rule of its own: a licensee may always challenge the validity of a licensed patent, no matter its status under the license. A closer read of the case, however, reveals that this characterization is inaccurate—many questions remain open. For example, although the Court did create a bright-line rule with respect to the narrow jurisdictional question governing whether a federal court *may* hear MedImmune's case, it left open the question of whether the court *must* hear the case, let alone questions about which party might ultimately prevail…

As an initial matter, just because federal courts *may* here MedImmune's case, that does not mean that they *must* hear it. MedImmune's victory could be very short-lived if the district court decides that, in the discretion granted to it under the Declaratory Judgment Act, it should not hear the case.[25] This is unlikely, however: the district court indicated that it followed *Gen-Probe* out of obligation rather than choice.[26]

Assuming the jurisdictional hurdle is completely cleared, though, there is another matter the Supreme Court did not opine on: whether, in a case where the licensee has not repudiated the agreement (i.e., continues to pay royalties), licensee estoppel can or should apply in the merits of the dispute? The Court also did not opine on whether the language of the license agreement itself prohibits MedImmune from challenging the validity of the Genentech patent.

Looking to the Future

The *MedImmune* Court dodged the fundamental licensee estoppel problem that consumed a significant portion of the briefing and oral argument in the case. It will now be up to the district courts and the Federal Circuit to decide how to apply *MedImmune* to that problem. If the Federal Circuit interprets *MedImmune* to mean that a licensee can challenge a patent in all circumstances, patent settlements may never be finalized because an accused infringer who is licensed in a settlement agreement will be able to bring repeated challenges to the validity of the licensed patent, while continuing to operate under the protection of the license, (safe from an injunction or claims for enhanced damages). On the other hand, if the Federal Circuit limits *MedImmune* to its narrow jurisdictional holding, similar to what it has done with *Lear*, it may still successfully revive licensee esoppel. If this happens, a licensee may never be able to stop paying royalties on a licensor's patent, even if the patent is later declared invalid by a court or the PTO.

A *C.R. Bard*-like totality of the circumstances test for deciding when courts should allow licensees to challenge a licensed patent would go a long way toward solving the dilemma of how to allow licensees to invalidate questionable patents, while not opening the floodgates to frivolous or speculative challenges by licensees looking for a free shot. Had the Federal Circuit applied a totality of the circumstances test in *Gen-Probe* and *MedImmune*, it might have held that Gen-Probe was estopped from challenging the patent, but MedImmune was not. This reasonable result would have gone a long way toward establishing a framework for resolving the dilemma caused by either of the proposed bright-line rules.

Patent Policy

A patent is a time-limited government-granted monopoly over the invention—an apparatus (product) or method (process)—defined in the relevant claim. A single patent may have hundreds of claims, each claim functioning as its own stand-alone patent. In many ways patents are similar to other monopolies granted by the government to private interests. For example, the government grants geographically limited monopolies to public utilities, in order to encourage development of expensive infrastructure, by guaranteeing exclusive use of the infrastructure and a given rate of return on the investment. Similarly, the monopoly granted in a patent allows the inventor time-limited exclusive use of the invention in order to encourage innovation and allow the inventor to recoup investment (and further invest) in the development of his invention. In exchange for this monopoly grant, the government does not require investment, as it might with a public utility, but does require disclosure of the invention so that it will enter the public domain on expiration of the patent, so that others may freely use, and invest in, the technology.[27]

Most economic conservatives and libertarians are generally skeptical of both the competence of federal agencies and the government's granting of monopolies to private interests. These parties often seek to limit the use of government-granted monopolies (utilities, port authorities, etc.) as much as possible, and, when granted, to limit the scope as much as possible. For many, however, skepticism of agency competence and government monopoly-granting seems to fade when it comes to monopolies granted in the form of patents. This is true

despite statistics that indicate that, when it comes to granting patents, the government would do just as well flipping a coin: studies indicate that approximately *half* of all patents litigated to a final judgment on validity are held invalid.[28] Of course, patents on which there is a significant question of validity may be more likely to be litigated to final judgment. Nevertheless, this is a troubling finding for advocates of free and open competition, especially considering that many cases involving patents that would very likely be found invalid end up settling due to the accused infringer's aversion to even a low risk of an injunction and to his assessment of above-market damages.

There is no questioning the value of properly granted patents in encouraging investment in innovation and technological development. This is particularly true in industries such as pharmaceuticals, where the required investment in researching, developing, and testing a product is considerably high, but the costs of reverse engineering and copying the product are low. It is also true, however that an invalid patent is an unnecessary tax on innovation (and consumers) when enforced against an independent developer of the same technology.

Static vs. Dynamic View of Patents

Most of the case law, as well as the parties and many of the amici in the *MedImmune* case, take a simple "static" view of patents and patent licenses. In this view, patent claims, and their application to products, are well-defined and certain at the time of the signing of a license agreement, and throughout the term of the license. Under this static view, it is easy to make analogies between patent (intellectual property) rights and rights in physical property, such as real estate. To those who advocate a static view of patents, goals of certainty and finality are very important, so that questions of the scope and enforceability of a patent can be settled; an analogy to the idea of a "quiet" title in real estate. Advocates of this viewpoint also argue that from a contract perspective, the parties to a license agreement require certainty and finality in their agreement.

Far from being static, however, real world patents and licenses are dynamic entities. New information about prior art, on-sale products, or public disclosures may (and often do) come to light years after a patent has issued. This information can cause a patent previously thought to be valid to be completely invalidated, and thus the covered invention is in the public domain. Furthermore, patent owners may advocate very different interpretations of their patent claims depending on the situation. Also, by filing so-called "continuation" applications, a patent applicant can obtain a first patent on an invention while keeping the supporting application alive in the patent office for several years to pursue additional claims, maintaining the benefit of the original filing date for the later applications. This is what Genentech did in order to obtain the Cabilly II patent.

In contrast to real estate, where the metes and bounds of a piece of property are known, (or at least knowable through a relatively inexpensive survey), the metes and bounds of a patent, as defined in the claims, are much more uncertain, flexible, and subject to change. A single invention may be covered by hundreds of different patent claims, each functioning as its own separate patent. Furthermore, the metes and bounds of each patent claim cannot be rigorously determined through an inexpensive survey, but must be determined through costly patent office procedures or litigation that may take several years.

Bright Line Rules vs. Totality of the Circumstances

While those who subscribe to a static view of patents often advocate for bright line legal rules that will provide certainty and finality in patent issues, those who understand the dynamic view of patents know that certainty and finality with respect to many issues in patent licensing are illusions. Since patents are, in reality, dynamic creatures, static-view advocates of bright-line legal rules to provide certainty and finality in patent licensing are really arguing to shift the certainty/uncertainty from one party to the other. For example, a bright line legal rule that prevents a patent licensee from ever challenging the validity of a licensed patent provides great certainty for the patent owner: he will never face a validity challenge no matter what claims he is able to obtain from the patent office or how he chooses to interpret his claims against the licensee's products. This result, however, creates great *un*certainty for the licensee: he may be forced to pay royalties on additional products for continuation patents with (perhaps questionable) claims that were not even drafted when the license agreement was signed and which he could not have anticipated would issue from the patent office.

On the other hand, a bright line legal rule that allows the licensee always to challenge the validity of a licensed patent provides the licensee with a high degree of certainty; because, should he lose a validity challenge, he has protected his downside: his products are immune from a patent injunction and he has a preset royalty rate that the licensor cannot increase. The licensor, however, under this rule, faces far greater uncertainty as he may be subject to multiple, repeated validity challenges from the licensee each time the licensee finds new prior art or other potentially invalidating facts.

On remand, MedImmune will continue to argue that it is unfair that it should have to subject itself to the risk of a potentially ruinous injunction in order to challenge the scope of patent claims that were not in existence at the time it entered into the license agreement. On the other hand, Genentech will argue that, jurisdictional questions aside, it is unfair to allow a licensee to operate under the benefit of a license agreement while attacking the agreement as voidable. Genentech will further argue that if the courts extend the *MedImmune* ruling to the merits of the case, there will be a rash of patent litigation with licensees suddenly unhappy with their bargains bringing (or threatening) invalidity suits in order to attempt to change the terms of their deals, all while using their license agreements to protect their downside risk. Genentech will also claim that patent litigation will increase because the uncertainty of continuous expensive validity challenges will lead patent owners to seek the finality and certainty of court judgments rather than the uncertainty of patent licenses.

If Genentech prevails on the merits, however, it is unclear that a licensee would have *any* mechanism to stop paying royalties on a patent that had been declared invalid by the

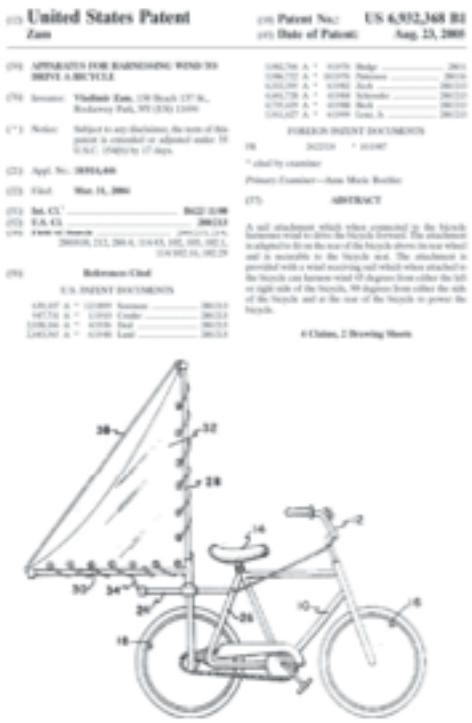
PTO (e.g., in an interference or re-examination proceeding) or a court in a case between other parties. It has generally been fundamental in patent law that a patent, once invalidated by a single court or the PTO could not be enforced against any party. However, if a licensee to the patent is always required to breach its license in order to challenge the validity of a licensed patent, licensors may effectively estop licensees from ceasing payments by licensing multiple patents—thereby subjecting the licensee to a suit on another patent if it ceases paying royalties on the invalid one, even where the patent has already been invalidated.

If the case makes it back up to the Supreme Court on the merits, it is difficult to predict how the Court will come out. During oral argument, the Justices expressed concern over the prospect of a flood of validity challenges in the courts. They also seemed skeptical of MedImmune's efforts to escape from a bargain it had intentionally and rationally entered into. On the other hand, during Genentech's argument, the Justices challenged Genentech's characterization of the license agreement as a type of compromise settlement of claims that MedImmune was trying to repudiate. The Justices recognized that the license at issue was a commercial patent license that included not-then-existing patents that could issue in the future, not the settlement of a litigation in which there were precise claims being asserted and settled.

Neither the oral argument nor the *MedImmune* opinion, however, give any hint that the Supreme Court would adopt a totality of the circumstances test to help solve these problems. In fact, Justice Breyer stated during oral argument: "[T]here are three possible positions on the question of whether a licensee can attack a contract…. One, he can never do it. Two, he can always do it. Three, it depends on what the contract said."[29] The Justices did not consider (and the Assistant to the Solicitor General arguing at the time did not raise) a fourth possibility: that it depends on the circumstances.

A totality of the circumstances test could reduce the number of validity challenges by holding non-breaching licensees to their deals on issues that were settled by those agreements, but allowing challenges in situations of changed circumstances, (such as a newly issued patent or a new claim interpretation asserted by the licensor), or the discovery of new information. As advocated by the amicus curiae American Intellectual Property Law Association (in a brief supporting Genentech), a court could certainly perform a factual inquiry to determine if the party challenging the patent was attempting to re-litigate an agreed settlement or secure the protection of a license simply to protect its downside, should its validity challenge fail.

As described above, the Federal Circuit's aversion to *Lear* seems to stem, at least in part, from favoring the values of finality and certainty in patent licensing over the licensee's right to challenge the patent. What this eventuates, however, is the favoring of *licensors'* interests in finality and certainty. A ruling applying licensee estoppel on the merits would increase licensors' finality and certainty at the expense of licensees. Licensors would be certain in the knowledge that their patents could not be attacked, but licensees would suffer a corresponding loss of certainty in that the licensor would then be able to take any interpretation of the patent claims it wanted with impunity. Licensees would not know whether or how licensors intended to assert a royalty obligation against future products the licensee may develop or acquire. Fully protected from a patent challenge, the licensor may adopt a claim interpretation, or obtain a continuation patent claim that is plainly invalid, but the licensee cannot challenge the new claim or interpretation without breaching the agreement and putting his existing products at risk of injunction.



For purposes of illustrating this scenario, suppose a bicycle shop owner licenses the actual patent shown above for a device to harness wind on a bicycle and begins manufacturing "sail bikes" as shown in the figure. As a gross over-simplification, assume a hypothetical claim for this invention recites the following elements: a bicycle, a sail, and a mast; where the sail is connected to the mast and the mast is connected to the bicycle. The bicycle shop owner produces sail bikes that meet with moderate success, but the patent owner becomes dissatisfied with the amount of royalties he is receiving, so he approaches the shop owner and demands that he also pay the negotiated royalty rate on all the jackets the shop sells because the jackets are marketed to cyclists who sometimes wear them on windy days, where they happen to catch the wind that helps to propel the bike just like a sail. The patent owner argues that in this case the cyclist functions as the mast in the claim and is connected to (wears) the jacket. The jacket functions as the sail when it catches a tail wind, and the cyclist is attached to the bike via the seat. Of course, this interpretation of the claim would make the patent clearly invalid, as the shop owner himself has been selling jackets for years before the March 2004 filing date of the sail bike patent. A bright line rule prohibiting a patent validity challenge by a licensee in good standing, however, would prevent the shop

owner from challenging this interpretation of the patent claim, unless he was willing breach the contract and subject his sail bike business to a certain injunction, since he acknowledges that, interpreted as he originally thought when he signed the license agreement, the patent is valid. Although this may seem a fanciful example, the reader is asked to consider that a patent issued to the infamous Jerome Lemelson that was asserted against both the Gillette Mach3 razor and the semiconductor manufacturing industry claimed that the invention described in the eleven-page specification was both a specialized-material manufacturing apparatus and a rocket engine.[30]

As shown in the sail bike example, for every gain in certainty and finality by a licensor, there is a corresponding loss of certainty and finality for the licensee. Any time a licensor becomes dissatisfied with his bargain, he can assert a brand new interpretation of his patent claims against other licensee products in an effort to extort a concession or force the licensee to choose between paying additional royalties and giving up the license. Additionally, the licensor could use continuation practice to obtain additional patent claims from the PTO, which may be of questionable validity and very different scope from the original claims in existence at the time of the license. This would discourage potential licensees from entering into license agreements since that means they may find themselves stuck paying royalties without the possibility of an invalidity challenge, while the competitor who chose not to take a license is free to challenge validity. Instead, many potential licensees may risk a litigation in which rights to challenge validity would at least be preserved.

Options for "Purchasing" Certainty and Finality

Given that, under a bright line rule, one party or the other will suffer a loss of certainty and finality, it makes sense to ask how future parties will protect themselves, depending on how cases like *MedImmune* are decided on the merits. If courts continue to constrain the application of *Lear*, licensees will seek to gain certainty by solidifying the licensor's patent claims at the time of the signing of the license. Since it would be their only shot, each licensee will attempt to limit the future patent claims the licensor can assert against it by memorializing specific claim interpretations in the license agreement. This will essentially turn every patent license into a *Markman* brief.[31] This will have the effect of greatly increasing the cost of patent licensing to both sides of the transaction as well as bogging down licensing negotiations in endless squabbles over the interpretation of various patent claim terms.

If the courts adopt a bright line rule that extends *Lear*, licensors are likely to add "no challenge" clauses to their licenses, although the enforceability of such clauses would be questionable. They might also add provisions for increased royalties or fee shifting if the licensee challenges a patent, or if the licensee mounts an unsuccessful challenge. Additionally, licensors will probably require greater up-front payments, and the use of running royalties will diminish.

More fundamentally, however, licensors may simply choose to invest in obtaining higher-quality patents. Patent practitioners know that it is extremely difficult to challenge a patent in court based on prior art that has already been scrutinized by the PTO. By investing more up-front in prior art searches and other due diligence measures (or petitioning the patent office to re-examine issued patents when new prior art is discovered), patent owners can "buy" as much certainty and finality as they want to invest in.

If a licensor wants to insulate himself from endless patent validity challenges, he need only invest in making sure any potentially invalidating art is before the patent examiner when the application is under review and that his claims are narrow enough to distinguish from the art. The patent owner may also invest in researching potential on-sale bars and other events that might invalidate the patent. By addressing these issues up-front, the patent owner will not only be taking arguments the licensee could use to challenge the patent off the table, he will be obtaining a stronger (perhaps narrower) patent. To put it another way, patent licensors should not be heard to complain about endless challenges to the validity of their patents when they have the option of insulating their patents against these challenges by investing more in the patent examination (or re-examination) process to make sure they are obtaining quality patents. While this will burden aspiring patent licensors with additional costs and may lead some to lose out on obtaining illegitimate patents they may otherwise have gotten through the patent office, the market at large will benefit from higher quality patents. There is no corresponding public benefit to *Markman*-style patent licenses. Of course, patent applicants are still welcome to under-invest in their patent applications, but the consequence may be a higher likelihood of a validity challenge down the road. Investment in higher quality patents will have a positive impact beyond the parties to a single licensing transaction, as they will better protect true innovators, while reducing the number of improperly issued patents.

Endnotes

1 Lear, Inc. v. Adkins, 395 U.S. 653 (1969).

2 MedImmune, Inc. v. Genentech, Inc., et al., 127 S.Ct. 764, 81 U.S.P.Q.2d 1225, 07 Cal. Daily Op. Serv. 278 (U.S., Jan 09, 2007) (NO. 05-608).

3 395 U.S. 653 (1969).

4 United States Patent and Trademark Office.

5 A court may find a patent claim invalid any time after it is issued by the PTO if a party demonstrates that the statutory patentability requirements (35 U.S.C. §§ 101-105) are not met or if the patent owner has misused the patent or obtained the patent through inequitable conduct before the PTO.

6 395 U.S. at 669.

7 *Id.* at p. 670-71.

8 U.S. Cons. art. I, § 8 (emphasis added).

9 35 U.S.C. § 1 *et seq*.

10 C.R. Bard, Inc. v. Schwartz, 716 F.2d 874 (Fed. Cir. 1983).

11 *Id.* at 880.

12 *Id.*

13 Studiengesellschaft Kohle, M.B.H. v. Shell Oil Co., 112 F.3d 1561 (Fed. Cir. 1997).

14 *Id.* at 1568.

15 Gen-Probe Inc. v. Vysis, Inc., 359 F.3d 1376 (Fed.Cir. 2004).

16 The Cabilly I patent is U.S. Patent No. 4,816,567 (filed April 8, 1983 and issued March 28, 1989); the Cabilly II patent, a continuation of Cabilly I, is U.S. Patent No. 6,331,415 (filed June 10, 1988 and issued December 18, 2001). As a continuation application, Cabilly II has an effective filing date of April 8, 1983, just like Cabilly I. Since the Cabilly II application was filed prior to June 8, 1995, its term is governed under the old rules, which provided for expiration 20 years from filing or 17 years from issuance, whichever is longer.

17 MedImmune, Inc. v. Genentech, Inc., et al., 427 F.3d 958 (Fed. Cir. 2005)

18 MedImmune, Inc. v. Genentech, Inc., et al., CV 03-2567 (C.D. Cal. Jan. 14, 2004; February 18, 2004; Mar. 15, 2004; April 29, 2004).

19 427 F.3d 958, 962 (citation omitted).

20 *Id.*

21 28 U.S.C. § 2201.

22 127 S.Ct. 764.

23 *See, e.g.*, Terrace v. Thompson, 263 U.S. 197 (1923) (plaintiff can challenge state anti-alien land law without actually entering into a lease); Steffel v. Thompson, 415 U.S. 452 (1974) (plaintiff can challenge state statue prohibiting handbill distribution without actually distributing handbills).

24 127 S.Ct. 764.

25 28 U.S.C. § 2201(a).

26 127 S.Ct. 764 (citing App. to Pet. for Cert. 31a).

27 Currently twenty years from the filing of the application.

28 *See e.g.*, John R. Allison & Mark A. Lemley, *Empirical Evidence on the Validity of Litigated Patents*, 26 AIPLA Q.J. 185 (1998).

29 MedImmune v. Genentech, Supreme Court Argument Transcript at 20 (available from www.supremecourtus.gov/oral_arguments/argument_transcripts.html).

30 *See* U.S. Patent Nos. 4,666,678 and 4,702,808.

31 *Markman* briefs and hearings are used in the claim interpretation phase of a patent litigation, and are named after *Markman v. Westview Instruments, Inc.*, 517 U.S. 370 (1996), the case that finally settled that claim interpretation is a question of law (not fact) for the court (not the jury) to decide.