

RATNERPRESTIA IP TRANSACTIONS UPDATE: US SUPREME COURT UNLEASHES PATENT LICENSEES

On January 9, 2007, the Supreme Court issued a landmark decision in *Medimmune, Inc. v. Genentech, Inc.* that shields patent licensees from an infringement suit while they attack the validity of the licensed patents. Using this new shield, licensees can pay the required royalties and simultaneously bring declaratory judgment actions attacking the validity of the licensed patents so as to avoid future royalties. Licensees no longer need to withhold royalties and suffer termination of the license and the harsh realities (treble damages and an injunction) of possibly losing a patent infringement suit.

This decision will likely lead to an increase in declaratory judgment actions between licensors and licensees and will result in an explosion of negotiations between licensors and licensees seeking a reduction in royalties because of the alleged invalidity of the licensed patents. With all of the questions that the *Medimmune* decision doesn't address, licensors' lawyers will likely be developing creative new license terms that will test the limits of that decision and licensees' lawyers will be developing defensive strategies to protect the options opened by *Medimmune*.

To understand the power shift wrought by *Medimmune*, look at the pre-*Medimmune* world. In 1969, the Supreme Court reshaped the licensor-licensee relationship in *Lear v. Adkins* 395 U.S. 653 (1969) by abolishing the licensee estoppel doctrine that precluded a licensee from attacking the validity of the licensed patent(s) and by rendering unenforceable contract terms that precluded such an attack. As the law evolved after *Lear*, licensees had to cease their royalty payments, suffer termination of the license agreement and litigate in the licensor's suit for unpaid royalties and patent infringement. Absent a termination of the license agreement, the licensee was precluded from challenging validity in a declaratory judgment action because a licensee, by definition, could not be under apprehension of an infringement suit. As a loser in an infringement suit, the former licensee was subject to an injunction and treble damages.

In *Medimmune*, the Supreme Court reviewed the dismissal of a declaratory judgment action brought by a patent licensee who continued to pay royalties "under protest and with reservation of all [its] rights." The Court held that the licensee was not required "to break or terminate its 1997 license agreement before seeking a declaratory judgment in federal court that the underlying patent is invalid, unenforceable, or not infringed."

Under *Medimmune*, a licensee has nothing to lose by challenging the validity of the licensed patents except for legal fees and, possibly, the royalties paid during a successful validity challenge. Note that *Medimmune* does not address the licensees' recovery of royalties paid during the validity challenge.

While we await the predictable litigation and negotiations, we encourage our clients to think about what new approaches licensors will develop for future license agreements and how licensees may respond. Here are some initial thoughts, from the licensors' point of view, but they are thoughts that need to be carefully studied before implementation.

1. Licensors think they are finalizing the settlement of a patent dispute when they sign a license agreement. Under *Medimmune*, finality is deferred to a later time when the courts decide on

validity. To put finality back into the agreement, how about the obvious - a clause that gives the licensor the right to terminate the license if the licensee challenges the validity, enforceability or infringement of the licensed patents. *Lear* and *Medimmune* must be studied to see whether this approach is enforceable.

Another approach and one that a prospective licensee might find more palatable is a clause awarding attorney's fees and costs to the prevailing party in the validity challenge.

If it appears that a contentious patent dispute is likely to be settled with a license agreement, the licensor could file an infringement action while the dispute is negotiated. When the dispute settles, the license agreement can be incorporated in a Consent Judgment finding the patent valid and infringed. The Licensor might then have available a *res judicata* defense in a subsequent validity challenge.

In international transactions, we could see arbitration clauses designating a foreign country as the situs coupled with clauses applying licensor-friendly foreign law for the contract issues and U.S. patent law for the validity issues.

A further possibility is for one party or the other to require that, if validity is challenged, the validity issue must be tried to a jury in a specific court, e.g., that party's local court.

2. Other questions not addressed in *Medimmune* relate to the status and recoverability of the royalties paid during the validity challenge. Licensors may require clauses that prohibit the licensee from escrowing the royalties during the validity challenge and that require payment directly to the licensor irrespective of the validity challenge. Clauses that preclude the licensees' recovery of royalties paid during a successful validity challenge are also likely.

3. Hybrid license agreements, i.e., technology transfer and patent license agreements, present their own questions. In hybrid agreements, we expect to see the license grant and royalty obligation limited to the use of the technology; it would also include the licensors promise to not assert its patents (without specifying any particular patents), as opposed to a positive license grant under specified patents.

Alternatively, if a hybrid agreement includes a positive license grant for specified patents, licensors will likely set two royalty rates, one for use of the technology and another for the use of the patents. If the patent is later held invalid, then the technology royalty would be arguably payable.

There are instructive pre-*Medimmune* lower court decisions that give insights into the viability and limits of the approaches suggested above and these decisions must be carefully studied by licensors and licensees. Developing a path through this thicket of cases and policy considerations will be a challenge to both businesses to determine what is commercially feasible and lawyers to determine what is legally defensible.

This paper is not to be construed as providing legal advice. For legal advice or more information on how *Medimmune* may affect your current or future license agreements, please contact Bob Seitter or Chris Lewis at RatnerPrestia's Valley Forge office.