Patent Owners Beware: Offering a License Could Land You in Court

by Michael I. Coe, Stephen W. Palan and Mark M. Supko

In a recent decision sure to have far-reaching consequences for patent owners, the U.S. Supreme Court in *MedImmune v. Genentech* rejected the traditional "reasonable apprehension of suit" requirement for bringing a declaratory judgment action on a potentially infringed patent.[1] Now, as the federal circuit confirmed in *SanDisk v. STMicroelectronics*, there appears to be virtually no circumstance under which a patent owner can offer a license to a potential infringer without risking a lawsuit.[2]

Declaratory Judgment Jurisdiction Before *MedImmune*

Grounded in Article III of the U.S. Constitution, the Declaratory Judgment Act creates subject-matter jurisdiction in federal courts only where there is a case of "actual controversy" between the parties.[3] To determine whether the actual controversy requirement was met in a given declaratory-judgment case, the U.S. Court of Appeals for the Federal Circuit (the court to which all patent appeals are taken) traditionally required a showing of some affirmative action by the patentee that justified a reasonable apprehension of an infringement suit on the part of the declaratory-judgment plaintiff, plus some activity by the plaintiff sufficient to show that the potentially infringing conduct had occurred or was at least imminent.[4] The effect of the reasonable apprehension of suit requirement was that a patentee generally could offer a license without a substantial risk of a declaratory-judgment action simply by taking care not to accuse the prospective licensee of infringement.[5]

Rejection of the Reasonable Apprehension of Suit Test

Ironically, despite the chilling effect that *MedImmune* may have on patent licensing offers, the case actually arose in the context of a fully executed license agreement. MedImmune, a drug manufacturer, had licensed an existing Genentech patent and a pending patent application relating to the production of certain antibodies. After the patent application issued, Genentech informed MedImmune that its most popular drug product, Synagis, was covered by the newly issued patent, and that Genentech therefore expected additional royalties under the license agreement.

While MedImmune believed the new patent did not cover its product, it was unwilling to breach the license agreement and risk the possibility of treble damages, attorney fees and an injunction, since Synagis accounted for as much as 80 percent of MedImmune's revenue. So MedImmune paid the additional royalties under protest, but then filed an action seeking a declaratory judgment of noninfringement and invalidity as to the new patent.

The district court dismissed MedImmune's declaratory judgment action for lack of subject-matter jurisdiction, relying on well-established Federal Circuit precedent holding that a patent licensee in good standing cannot satisfy the reasonable apprehension of suit requirement.[6] The Federal Circuit affirmed the dismissal, relying on the same precedent.[7] MedImmune then appealed its case to the Supreme Court.

In analyzing the dismissal of MedImmune's declaratory judgment action, the Supreme Court first reviewed its own precedent interpreting the Declaratory Judgment Act. While conceding that its cases "do not draw the brightest of lines between those declaratory-judgment actions that satisfy the case-or-controversy requirement and those that do not," the Court observed that its decisions require a real, substantial, definite and concrete dispute for which specific relief can be granted.[8]

As framed by the Supreme Court, the key question in the case at hand was whether a party can satisfy the "actual controversy" requirement of the Declaratory Judgment

Act even though its own actions (e.g., MedImmune's payment of royalties) eliminated any imminent threat of harm (i.e., a patent infringement suit by Genentech). The Supreme Court answered yes, by analogizing to cases involving coercive government action. It noted that in such cases, a party facing a genuine threat of government enforcement need not "bet the farm" by taking the violative action before seeking a declaration that it was acting within its rights.[9]

Thus, in the context of coercive private action, the Court reasoned that Article III does not require a declaratory-judgment plaintiff to "bet the farm" or "risk treble damages and the loss of 80 percent of its business" before seeking declaratory relief.[10]

Based on this analysis, the Supreme Court held that MedImmune need not break or terminate its license agreement with Genentech in order to seek a declaratory judgment against Genentech's new patent. The Supreme Court criticized the Federal Circuit's reasonable apprehension of suit test as "conflict[ing] with," "contradict[ing]," and "in tension with" Supreme Court precedent on the requirements for declaratory-judgment jurisdiction.[11]

The Federal Circuit's Broad Application of *MedImmune*

In *SanDisk v. STMicroelectronics*, the Federal Circuit relied on the Supreme Court's *MedImmune* decision to reverse a district court's dismissal of a declaratory judgment action for failure to present an actual controversy. However, unlike the facts in *MedImmune*, in *SanDisk* the accused infringer had not yet entered into a license agreement with the patentee.

STMicroelectronics (ST) had approached SanDisk seeking to cross-license certain of the companies' patents relating to flash memory-storage products. After exchanging several letters, the parties met and ST made a presentation that purported to show how SanDisk's products infringed various ST patents. At the conclusion of the meeting, ST presented SanDisk with a packet of materials that documented its infringement analysis, including diagrams detailing how SanDisk's products allegedly satisfied the elements of ST's patent claims. Likely mindful of the reasonable apprehension of suit requirement, ST acknowledged that these materials "would allow SanDisk to DJ" ST, but assured SanDisk that "ST has absolutely no plan whatsoever to sue SanDisk."[12]

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After several more months of negotiation, SanDisk brought an action for declaratory judgment of noninfringement and invalidity as to ST's patents. In response, ST moved to dismiss for lack of subject-matter jurisdiction. Applying the traditional reasonable apprehension of suit test (this was pre-*MedImmune*), the district court granted ST's motion on the basis that there was no actual controversy between the parties. The district court noted that ST's infringement analysis did not constitute an express charge of infringement and that, under the totality of the circumstances, there was no actual controversy because ST told SanDisk that it did not intend to sue.[13]

The Federal Circuit reversed, noting the recent rejection of the reasonable-apprehension-of-suit test in the *MedImmune* decision. While recognizing that *MedImmune* addressed declaratory-judgment jurisdiction in the context of a signed license agreement, the Federal Circuit analyzed how the Supreme Court's rationale should be applied to conduct prior to the existence of a license.

The Federal Circuit noted that, without some affirmative act by the patentee, a potential infringer merely learning of the existence of a patent or perceiving that a patent poses an infringement risk would not support declaratory-judgment jurisdiction. However, Article III jurisdiction would arise if a patentee's actions "put[] the declaratory judgment plaintiff in the position of either pursuing arguably illegal behavior or abandoning that which he claims a right to do."[14] ST's presentation of a detailed infringement analysis to SanDisk was deemed sufficient to satisfy this standard.[15]

In a concurring opinion in *SanDisk*, Judge Wilson Curtis Bryson accurately observed that the Federal Circuit's new test would have a broad reach. He noted that any invitation to license would give rise to an Article III case or controversy "if the prospective licensee elects to assert that its conduct does not fall within the scope of the patent."[16] Bryson opined further that, under this new standard, there is "no practical stopping point short of allowing declaratory judgment actions in virtually any case in which the recipient of an invitation to take a patent license elects to dispute the need for a license and then to sue the patentee."[17]

The Practical Effects of *MedImmune* and *SanDisk*

The *MedImmune* and *SanDisk* decisions reflect a new balance of power between patentees and potential infringers. No longer can a patentee offer a license to a potential infringer knowing that, so long as it does not explicitly or implicitly threaten an infringement suit, the patentee need not fear being dragged into protracted litigation. To the contrary, in the post-*MedImmune/SanDisk* world, a potential infringer presented with an offer of a patent license can establish declaratory-

judgment jurisdiction simply by taking the position that its activities fall outside the scope of the patent at issue.

As Judge Bryson implicitly recognized in his *SanDisk* concurrence, control over the timing of litigation is now shared by the prospective licensee. Even if the patentee is careful not to make any accusation of infringement, or even avoids identifying particular products that might be covered by a patent, a prospective licensee need only ask whether the patentee believes its activities fall within the scope of the patent.[18] If the patentee says no, it has made a damaging admission that will limit future litigation; if the patentee says yes or equivocates, it will have satisfied the *SanDisk* test and created declaratory judgment jurisdiction.[19]

The relaxation of the declaratory judgment jurisdictional requirement significantly diminished the leverage that patentees previously enjoyed in licensing negotiations. Under the old regime, a patentee typically would try to avoid creating declaratory-judgment jurisdiction to preserve the patentee's historical prerogative to decide whether, when, and where patent litigation would take place. This was a significant advantage, as the patentee could embark on licensing negotiations without forfeiting the ability to choose a convenient or strategically important forum, while also ensuring that a litigation did not commence until the patentee had completed its preliminary legal work (giving the patentee a further leg up on the potential infringer).[20]

Likewise, a patentee was often able to avoid the burden, risk, and expense of actually litigating its patents, yet still take advantage of the specter of litigation during licensing negotiations. The continued viability of these privileges of the patentee are now very much in doubt. Under the new regime, a patentee has a very limited ability to prevent a prospective licensee from taking the initiative itself by filing a preemptive suit at the time and in the forum of its choosing.

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A patentee that desires to control the course of litigation now has few options when making a license offer to a potential infringer. One possibility is to file suit first, and then negotiate with an accused infringer during the course of a pending lawsuit. This approach, however, involves the expense and burden of a lawsuit and also requires a reasonable investigation beforehand of the facts underlying the alleged infringement beforehand (i.e., to satisfy the requirements of Rule 11 of the Federal Rules of Civil Procedure), which may or may not be feasible or economical without information from the potential infringer. A variation on this approach is for the patentee to file but not immediately serve an infringement complaint against the potential infringer before offering a license. This would buy the patentee up to 120 days, under Rule 4(m) of the Federal Rules of Civil Procedure, to negotiate a license agreement before having to complete service of process. If a satisfactory agreement is reached, the complaint can be withdrawn. While such an approach may allow a patentee to effectively choose the forum (under the first-to-file rule), a significant downside is that 120 days may not be enough time to reach a deal if the licensing issues are complex. The approach could lead to undesired effort and expense to litigation while negotiations continue.

Conclusion

Under the new legal regime, patentees need to be more cautious and discriminating in how, and who, they approach in license negotiations. Those patentees who are unwilling or unable to litigate their patents in court must be especially careful, since they now have little control over whether a license offer will escalate into a lawsuit. Thus, it may be advisable to avoid "hard-ball" negotiation techniques which could provoke a retaliatory declaratory-judgment suit. In any event, patentees that seek to license their patents would be well-advised to do advance work in order to be able to bring suit quickly, or react quickly to a declaratory-judgment suit, in the event the negotiations break down.

Potential licensees, on the other hand, now enjoy a much more level playing field when approached for a patent license. The prospect of a declaratory judgment action may tend to deter those patentees who are merely "fishing" for royalties, and patentees with a more serious claim of infringement will likely approach license negotiations more gingerly than in the past. Those companies that are regularly targeted by royalty-seeking patentees should develop the capacity to file suit quickly when faced with a patent threat, as a well-chosen declaratory-judgment suit or two may establish a company's reputation as an uninviting target.

Although the full ramifications of the *MedImmune* decision in the patent world have yet to be felt, at least one thing is clear: any patent owner who decides to offer a license to a potential infringer must be prepared to defend its patent rights in court. It also appears likely that fewer licensing offers will be made outside the context of litigation, as a patent owner must sue first or risk losing control over the timing and location of a lawsuit in which its patent rights will be determined. In an age when federal court dockets are already bogged down by ever-increasing

caseloads, an unfortunate consequence of *MedImmune* is thus the creation of a significant disincentive to trying to resolve patent disputes absent litigation. ⚖

Endnotes:

1 *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. ___, 127 S. Ct. 764 (Jan. 9, 2007).

2 *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372 (Fed. Cir. Mar. 26, 2007).

3 28 U.S.C. § 2201(a).

4 *See, e.g., Teva Pharm. USA, Inc. v. Pfizer, Inc.*, 395 F.3d 1324, 1330 (Fed. Cir. 2005); *BP Chems. Ltd. v. Union Carbide Corp.*, 4 F.3d 975, 978 (Fed. Cir. 1993).

5 *See, e.g., Phillips Plastics Corp. v. Kato Hatsujou Kabushiki Kaisha*, 57 F.3d 1051, 1054 (Fed. Cir. 1995); *see also Shell Oil Co. v. Amoco Corp.*, 970 F.2d 885, 888 (Fed. Cir. 1992).

6 *MedImmune*, 127 S. Ct. at 768 (citing *Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376 (Fed. Cir. 2004)).

7 *Id.*

8 *Id.* at 771 (citing *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-241 (1937)).

9 *Id.* at 772.

10 *Id.* at 775.

11 *Id.* at 774 n.11.

12 *SanDisk*, 480 F.3d at 1375-1376.

13 *Id.* at 1377.

14 *Id.* at 1381.

15 *Id.* at 1382.

16 *Id.* at 1384.

17 *Id.* at 1385.

18 *Id.* at 1384.

19 *Id.* at 1384-85.

20 Some federal courts are known to be well-versed in patent matters (*e.g.*, the U.S. District Court for the Northern District of California), particularly patent-friendly (*e.g.*, the U.S. District Court for the Eastern District of Texas), or fast (*e.g.*, the U.S. District Court for the Eastern District of Virginia).

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