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Licensing tips from a patent litigator

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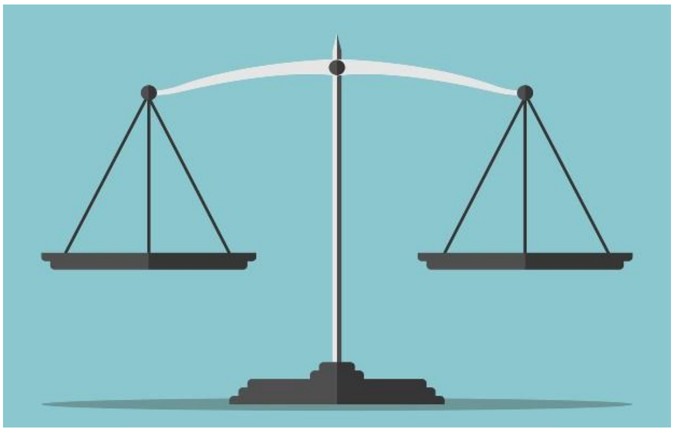

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Anyone drafting patent licence agreements should follow several tips in order to avoid or better prepare for litigation later on, says Jessamyn Berniker of Williams & Connolly.

Licence drafters have an unenviable task. Often they are forced to draft an agreement relating to patents whose claims have not yet been drafted and for a product in the earliest stages of development. It is no surprise that, years after these contracts are executed, the contracting parties often have disagreements about the proper interpretation and application of particular licence provisions. In order to avoid—or at least better prepare for—litigation down the road, it is important that those involved in drafting and carrying out licence agreements are aware of the types of disputes that can arise. A handful are identified here.

No-challenge clauses

After the US Supreme Court decided MedImmune v Genentech (2007), licensors started adding “no challenge” clauses into their licence agreements. In MedImmune, the court held that a licensee in good standing could challenge the validity of the licensed patent while maintaining the licence and thereby protect itself from an infringement claim.

No-challenge provisions are licensors’ efforts to contractually restrict licensees’ ability to do this: they provide that if the licensee begins an invalidity challenge in court or at the US Patent and Trademark Office, the licence will be terminated.

While these provisions probably provide some measure of deterrent effect, not all courts reviewing them have found them enforceable. In Rates Technology v Speakeasy (2012), for example, the Second Circuit held that such a clause entered into before litigation was unenforceable as contrary to public policy. The court in Canon v Tesseron (2015) held likewise.

Meanwhile, in Dot Hill Systems v Crossroads Systems (2015) the Patent Trial and Appeal Board (PTAB) declined to consider a patent owner's argument that an inter partes review petitioner was contractually prohibited from challenging a patent. The PTAB identified no statutory basis that would permit it to consider a contractual estoppel defence, presumably leaving the patent owner to try to enforce the provision in a breach of contract suit.

By contrast, the Federal Circuit did enforce such a provision in the context of a licence agreement reached in settlement of litigation. Relying on the "strong public interest in enforcing settlements", in Flex-Foot v CRP (2001), the court held that "once an accused infringer haschallenged patent validity,has had an opportunity to conduct discovery on validity issues, andhas elected to voluntarily dismiss the litigation with prejudice under a settlement agreement containing aclear and unambiguous undertaking not to challenge validity and/or enforceability of the patent in suit, the accused infringer is contractually estopped from raising any such challenge in any subsequent proceeding".

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A later Federal Circuit case, Baseload Energy v Roberts (2010), suggested that "in the context of settlement agreements, as with consent decrees, clear and unambiguous language barring the right to challenge patent validity in future infringement actions is sufficient, even if invalidity claims had not been previously at issue and had not been actually litigated".

In TMI Products v Rosen Electronics (2013), the district court enforced what it viewed as a clear and unambiguous no-challenge clause contained in what it characterised as a settlement agreement, despite the fact that the parties had not previously litigated or taken discovery on the validity of the asserted patents.

The last valid and infringed patent

Typically, when a licence is executed, the relevant patent estate's prosecution is ongoing and the contemplated product may be far from final. As a result, the parties are not in a position to negotiate and identify precisely which patent claims are valid and infringed. To deal with this, it is not uncommon for licence agreements to provide that the licensee will pay royalties so long as there is a valid claim that—but for the licence—would be infringed. Agreements also often provide that a claim is considered "valid" until it has been determined to be invalid by a decision from which no appeal has been or can be taken.

It is important for licensees to periodically review the licensed patent estate that ultimately issues so that they can assess which claims may be infringed and whether those claims would survive a validity challenge. When a first group of licensed patents in a portfolio expires, leaving only one or two patents that are not expired, the licensee may determine that its product would not infringe the remaining patents, or that any remaining and potentially infringed claims are invalid.

From the licensee's standpoint, it is best to identify any potential arguments before the earlier patents have expired, so that it can bring suit before it faces the prospect of paying royalties on patents it believes are invalid or not infringed.

The "tail"

Another issue that often arises when a patent estate nears expiration is whether products manufactured before the expiration of the patent, but sold after it, require payment or whether only products sold before the expiration trigger a royalty. For products with significant sales, which are often advance-manufactured in large quantities, the difference between these two end dates can mean a significant amount of money.

One example where a court addressed this issue is Pacesetter v SurModics (2011). In that case, St. Jude Medical agreed to pay quarterly royalties to SurModics during the term of the agreement on net sales of licensed products. The court determined that because sale, rather than manufacture, of the licensed products triggered the royalty obligation, St. Jude was not required to pay royalties on products manufactured before, but sold after, the agreement ended. The Ninth Circuit affirmed in 2013.

The net sales clause

The "net sales" clause,found in some form in nearly every running royalty licence agreement, defines the royalty base to be used in the calculation of royalties. This clause typically sets forth a series of exclusions from the revenues on which royalties are due, including, for example, taxes, tariffs, discounts, rebates, etc. It is surprising how often these provisions become part of a licence dispute—not always the central issue, but one that frequently arises as parties debate precisely what is meant by the exclusions.

There is no perfect fix for the drafter, but it is worth considering whether to be more specific in addressing the permissibility of specific exclusions when drafting a net sales clause.

Patent exhaustion

Licensing attorneys should have at least one Supreme Court case on their radar. In Impression Products v Lexmark International,the court is considering two issues relating to patent exhaustion. This decision may well impact the drafting of future licences and affect parties' freedom to operate under current licences.

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