

# LIMITING UNFETTERED CHALLENGES TO PATENT VALIDITY: UPHOLDING NO-CHALLENGE CLAUSES IN PRE-LITIGATION PATENT SETTLEMENTS BETWEEN PREEXISTING PARTIES TO A LICENSE

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## INTRODUCTION

The 2007 United States Supreme Court decision of *MedImmune, Inc. v. Genentech, Inc.*<sup>1</sup> has altered the patent licensing landscape by making it easier for patent licensees to bring declaratory judgment actions against patentees in order to challenge the validity of the licensed patent.<sup>2</sup> In *MedImmune*, the Court held that a licensee does not

<sup>1</sup> 549 U.S. 118 (2007).

<sup>2</sup> See, e.g., Michael Donovan, *The Impact of MedImmune, Inc. v. Genentech, Inc. and Its Progeny on Technology Licensing*, 3 J. BUS. ENTREPRENEURSHIP & L. 39, 57 (2009) (“[I]n light of *MedImmune*, a licensor must worry about the vastly increased likelihood of litigation. . . . This shift in the existing license landscape has decidedly slanted the playing field toward the licensee.”); Rochelle Cooper Dreyfuss & Lawrence S. Pope, *Dethroning Lear? Incentives to Innovate After MedImmune*, 24 BERKELEY TECH. L.J. 971, 973 (2009) (“[The *MedImmune* decision] effects a dramatic change in the rules of the licensing game by substantially enhancing the bargaining position of the licensee to the detriment of the patent holder.”); Richard Weil

have to repudiate the license<sup>3</sup> in order to have standing<sup>4</sup> to bring a declaratory judgment action seeking to invalidate the patent.<sup>5</sup> By allowing such a nonrepudiating licensee to challenge patent validity, *MedImmune* allows licensees to threaten patentees with the burden and litigation, including extensive and expensive discovery, and the risk that the patent will be found invalid.<sup>6</sup> One logical way for a patentee to protect against such behavior is to bargain for a clause in the license that prevents the licensee from challenging the patent's validity. However, since the 1969 Supreme Court decision of *Lear, Inc. v. Adkins*,<sup>7</sup> such clauses, so-called "no-challenge clauses,"<sup>8</sup> have been struck down in license agreements as virtually per se invalid.<sup>9</sup> This Note addresses whether, and if so to what extent, parties can privately negotiate for no-challenge clauses in settlement agreements, specifically those between parties to a preexisting license. Framed another way, even if a license cannot contain a no-challenge clause, can further negotiations between a patentee and licensee yield an agreement that contains one?

In *Lear*, the Supreme Court overturned the doctrine of licensee estoppel, a judicially created doctrine that prevents a licensee from

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Goldstucker, *Stop the Bleeding: MedImmune Ends the Unjustified Erosion of Patent Holders' Rights in Patent Licensing Agreements*, 16 J. INTELL. PROP. L. 137, 139 (2008) ("The *MedImmune* decision, on its face, has left patent holders defenseless. Licensees can negotiate a patent license and face no risk in challenging the validity of the patent.").

<sup>3</sup> Repudiating the license would subject the licensee to a suit of infringement. See, e.g., *Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376 (Fed. Cir. 2004).

<sup>4</sup> In *MedImmune*, the Supreme Court noted that the issue it faced could be termed as an issue of "standing" or of "ripeness." *MedImmune*, 549 U.S. at 128 n.8 ("The justiciability problem that arises, when the party seeking declaratory relief is himself preventing the complained-of injury from occurring, can be described in terms of standing (whether plaintiff is threatened with 'imminent' injury in fact 'fairly . . . trace[able] to the challenged action of the defendant'), or in terms of ripeness (whether there is sufficient 'hardship to the parties [in] withholding court consideration' until there is enforcement action). As respondents acknowledge, standing and ripeness boil down to the same question in this case." (omission and alterations in original) (citations omitted) (internal quotation marks omitted)). For the purpose of consistency within this Note, the term "standing" will be used because of the consistent use of the phrase "in good standing" in the case law.

<sup>5</sup> *MedImmune*, 549 U.S. at 137.

<sup>6</sup> Licensees can use this threat to renegotiate or amend a current license. Some reasons for doing so include: demanding lower royalty rates, increasing the term of a license that will soon expire, expanding the list of products that the license covers, or altering specific provisions in the license such as which divisions of a corporation may practice the invention or whether the licensee has the ability to sublicense or assign the license.

<sup>7</sup> 395 U.S. 653 (1969).

<sup>8</sup> A no-challenge clause, also called a no-contest clause, is contained in an agreement between a patentee and licensee and prohibits the licensee from subsequently challenging the validity of the patent covered in the agreement. It is essentially an explicit version of licensee estoppel. See 19 ALAN S. GUTTERMAN, BUSINESS TRANSACTIONS SOLUTION § 88:114 (2014).

<sup>9</sup> See, e.g., *Bendix Corp. v. Balax, Inc.*, 471 F.2d 149, 158 (7th Cir. 1972); *Plastic Contact Lens Co. v. W.R.S. Contact Lens Labs., Inc.*, 330 F. Supp. 441, 443 (S.D.N.Y. 1970).

challenging the validity of the patent it is licensing.<sup>10</sup> The Court recognized the strong federal patent policy of ensuring that ideas that are truly in the public domain remain free for the public to use and employed a balancing test, holding that this federal interest outweighed state contract law principles.<sup>11</sup> The decision not only removed an absolute bar from a licensee's ability to challenge patent validity, but it has since stood for eliminating both judicially-created and privately-negotiated impediments, such as no-challenge clauses, in order to encourage challenges of patent validity.<sup>12</sup> However, critiques of *Lear* argued that the decision discouraged inventors from using the patent system because it made the exclusive rights of a patent less secure, which in turn decreased public disclosure of ideas<sup>13</sup> and encumbered incentives to invent,<sup>14</sup> two other goals of federal patent policy that were absent from *Lear*'s balancing test analysis.<sup>15</sup>

In *MedImmune*, the Supreme Court had the opportunity to reexamine and address *Lear*'s balancing test. However, rather than doing so, the Court framed the issue in *MedImmune* as one of justiciability and left open the issue of whether *Lear*'s balancing test stands for removing all barriers standing in the way of patent validity challenges or whether some interests may tip the scale the other way.<sup>16</sup> This Note contends that the interests of promoting innovation through incentivizing invention and the disclosure of ideas may in some cases outweigh the federal patent policy of encouraging unfettered validity challenges and that the critiques of *Lear* deserve renewed attention following *MedImmune*.

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<sup>10</sup> *Lear*, 395 U.S. at 656 (“The theory underlying [the doctrine of licensee estoppel] is that a licensee should not be permitted to enjoy the benefit afforded by the agreement while simultaneously urging that the patent which forms the basis of the agreement is void.” (internal quotation marks omitted)).

<sup>11</sup> *Id.* at 670.

<sup>12</sup> See J. Thomas McCarthy, “Unmuzzling” the Patent Licensee: Chaos in the Wake of *Lear v. Adkins* (Part I), 59 J. PAT. OFF. SOC’Y 475, 476 (1977) [hereinafter McCarthy, Part I] (“The ‘spirit of *Lear*’ appears to be one of providing some incentive to licensees to encourage them to challenge patent validity and to eliminate obstacles to suit by those disposed to challenge the validity of a patent.”); see also *Bendix Corp.*, 471 F.2d at 157 (“The key policy motivation weighing the scales in *Lear* in favor of outlawing licensee estoppel was obviously the ‘unmuzzling’ of licensees to challenge patentability.”).

<sup>13</sup> See Goldstucker, *supra* note 2, at 157; David M. Treadway, Comment, *Has the Supreme Court Forgotten the Patentee? Recent Patent Licensing Decisions Contradict Patent Policy, Harm Licensees, and Alter Negotiation*, 33 U. DAYTON L. REV. 303, 321 (2008).

<sup>14</sup> See Goldstucker, *supra* note 2, at 154–55 (“It must be noted that one major goal of patent policy is to ensure that inventors can effectively exploit valid patents and therefore reap the rewards of their innovations. This fundamental incentive to invent is seriously skewed if licenses are under constant siege with no assurance of finality.” (footnote omitted)).

<sup>15</sup> See William C. Rooklidge, *Licensee Validity Challenges and the Obligation to Pay Accrued Royalties: Lear v. Adkins Revisited* (Part II), 69 J. PAT. & TRADEMARK OFF. SOC’Y 5, 15–16 (1987) [hereinafter Rooklidge, Part II].

<sup>16</sup> *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 120–21 (2007).

One circumstance in which the policy favoring patent validity challenges has been limited is when a settlement agreement resolves litigation over patent validity.<sup>17</sup> In settlements, courts have sometimes held that the competing public interest in the finality of disputes outweighs the encouragement of patent validity challenges.<sup>18</sup> However, not all settlement agreements are afforded such deference. Commentators have noted that settlement agreements are more likely to bar validity challenges when they are entered into after extensive litigation.<sup>19</sup> In the recent case of *Rates Technology Inc. v. Speakeasy, Inc.*,<sup>20</sup> the United States Court of Appeals for the Second Circuit found that discovery is the appropriate demarcation of when sufficient litigation has taken place to uphold no-challenge clauses.<sup>21</sup> However, this Note contends that whether the settlement agreement is between parties to a preexisting license is more important than the stage of litigation at which the agreement is reached. When an agreement is between a patentee and a licensee, this Note advocates for giving deference to the finality of settlement over the policy favoring validity challenges, even if the agreement is before litigation. Thus, while the *Rates Technology* court found it unimportant to distinguish between pre-litigation license agreements and pre-litigation settlement agreements,<sup>22</sup> this Note contends that pre-litigation agreements between parties to an existing license should be considered settlement agreements and accorded such respect.

Part I of this Note discusses the goals of patent policy, litigation, and licensing, as well as the background of *Lear* and *MedImmune*. Part II discusses how *MedImmune* has altered the patent licensing landscape and argues that *MedImmune* warrants providing patentees with more protection against unfettered validity challenges. Part III argues that in order to provide such protection, pre-litigation agreements between preexisting parties to a license should be treated as settlements and

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<sup>17</sup> See *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1369 (Fed. Cir. 2001).

<sup>18</sup> See *id.* at 1369–70 (“[T]here is a strong public interest in settlement of patent litigation and that upholding the terms of a settlement encourages patent owners to agree to settlements—thus fostering judicial economy.”); *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348, 350 (Fed. Cir. 1988) (“The law strongly favors settlement of litigation, and there is a compelling public interest and policy in upholding and enforcing settlement agreements voluntarily entered into.”); *Aro Corp. v. Allied Witan Co.*, 531 F.2d 1368, 1374 (6th Cir. 1976).

<sup>19</sup> See, e.g., M. Natalie Alfaro, Comment, *Barring Validity Challenges Through No-Challenge Clauses and Consent Judgments: MedImmune’s Revival of the Lear Progeny*, 45 HOUS. L. REV. 1277, 1290 (2008); J. Thomas McCarthy, “Unmuzzling” the Patent Licensee: *Chaos in the Wake of Lear v. Adkins (Part II—Conclusion)*, 59 J. PAT. OFF. SOC’Y 544, 562 (1977) [hereinafter McCarthy, Part II].

<sup>20</sup> 685 F.3d 163 (2d Cir. 2012).

<sup>21</sup> *Id.* at 172.

<sup>22</sup> *Id.* at 172–73. The *Rates Technology* court used the term “pre-litigation settlement” to describe an agreement that resolves a dispute about patent infringement or validity that occurs prior to litigation. *Id.* at 170.

accorded deference under jurisprudence recognizing that the interest in the finality of disputes can outweigh the federal patent policy of favoring unfettered validity challenges. Finally, Part IV of this Note proposes that no-challenge clauses in pre-litigation settlement agreements should be upheld in order to protect patentees and in turn promote innovation.

## I. BACKGROUND

The Supreme Court has articulated three purposes of federal patent law:<sup>23</sup> (1) to foster and reward invention, which is accomplished by incentivizing inventors with the grant of a patent and its exclusive rights,<sup>24</sup> (2) to promote the disclosure of inventions, which is realized through the requirement that inventors must disclose their inventions in order to receive a patent,<sup>25</sup> and (3) to ensure that ideas in the public domain remain free for the public to use, which is achieved by requiring that inventions be novel and nonpublic in order to be patentable.<sup>26</sup> All three purposes are premised on the broader aim, and constitutional mandate, of patent law to promote the progress of science and the useful arts.<sup>27</sup> However, promoting such innovation requires a careful balance between the three goals. Patent holders need sufficient protection of their exclusive rights or they may not be willing to invest capital into innovation in the first place. Further, without such protection patent holders may seek to protect the fruits of their labor through secrecy instead of disclosure. On the other hand, innovation is stunted if private parties can monopolize the use of public ideas. This Note addresses where the appropriate balance should be between providing patent holders with sufficient security to promote innovation and providing licensees, acting for themselves but also for the public,<sup>28</sup> with incentives to challenge that security in order to ensure public ideas remain free for the public to use.

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<sup>23</sup> The Supreme Court articulated these three purposes in *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480–81 (1974), and summarized them five years later in *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 262 (1979).

<sup>24</sup> See 1 JOHN W. SCHLICHER, PATENT LAW: LEGAL AND ECONOMIC PRINCIPLES § 2:10 (2d ed. 2012).

<sup>25</sup> See *id.* § 2:11.

<sup>26</sup> See *id.* § 2:12.

<sup>27</sup> U.S. CONST. art. I, § 8, cl. 8 (“To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries[.]”).

<sup>28</sup> Invalidating invalid patents inheres for the public good, but often the public does not have the means or incentive to challenge the validity of patents. See *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969) (“Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor’s discovery.”).

A. *How Patent Litigation and Licensing Impact Challenges to Patent Validity*

A patent grants to its holder certain exclusive rights, such as to make, use, and sell the patented subject matter (i.e., invention).<sup>29</sup> The ability to exploit these exclusive rights provides economic incentive to invent.<sup>30</sup> One way in which a patent holder can use its rights is by making, using, and selling the invention itself while preventing competitors from doing so. However, licensing patent rights to others is often more efficient because it allocates the rights to the party with the most economic interest in them.<sup>31</sup> Licensing also allows for wider practice of the invention before the end of the patent term, and such earlier disclosure further stimulates innovation. Thus, while use of the patent system is important to promote innovation because it incentivizes inventors to invent and rewards them for disclosing ideas, which become freely available to the public at the end of the patent term, use of patent licensing is even more important because it catalyzes innovation through efficiency and broader disclosure. Therefore, ensuring that patent holders feel secure in using the patent licensing scheme is important to foster innovation.

In order for patent holders to feel secure, they need to be able to protect their exclusive rights and face a level playing field when negotiating licenses. Patent holders protect their patent rights via infringement actions—alleging the unauthorized use of their exclusive rights.<sup>32</sup> An alleged infringer facing an infringement action will often raise the affirmative defense that the patent is invalid.<sup>33</sup> A finding of invalidity allows the alleged infringer, and any other party, to use the invention without needing permission—a license—and voids the exclusive rights granted to the patentee.<sup>34</sup> Thus, it is not surprising that patentees seek to avoid defending the validity of their patents.

Licensing can help patentees avoid the threat of validity challenges because licenses avoid litigation,<sup>35</sup> which means avoiding the affirmative defense of invalidity. Licensing is beneficial to the licensee as well.

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<sup>29</sup> 35 U.S.C. § 271(a) (2012); *see also* 2 SCHLICHER, *supra* note 24, § 11:12.

<sup>30</sup> *See* 2 SCHLICHER, *supra* note 24, § 13:4.

<sup>31</sup> For example, an individual inventor without any capital to manufacture his invention can license his patent rights to a corporation that does have the capital to make and sell the invention. Both the inventor and the licensee profit and the invention is distributed for public use, which otherwise might not have occurred.

<sup>32</sup> 2 ROBERT A. MATTHEWS, JR., ANNOTATED PATENT DIGEST § 10:1 (2014).

<sup>33</sup> *See* SCHLICHER, *supra* note 24, § 1:6.

<sup>34</sup> *See* 2 *id.* § 12:18 (“[B]ecause an invalidity judgment will free everyone to use the invention and free other licensees from their royalty obligations.”).

<sup>35</sup> Most of the cases discussed in this Note involve licensees that were entered into under such circumstances. *See, e.g.*, *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 165 (2d Cir. 2012); *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1363–64 (Fed. Cir. 2001).

Viewing litigation costs as the price an alleged infringer must pay, at a minimum, in order to make, use, or sell the patented subject matter,<sup>36</sup> a license is often attractive to an alleged infringer. Licenses also allow both parties to control risk—either of infringement or invalidity.<sup>37</sup> However, although licenses may decrease the risk of validity challenges, they do not eliminate them.

Before *Lear*, the doctrine of licensee estoppel protected patentees from validity challenges raised by their licensees, but *Lear* abrogated this judicially created estoppel.<sup>38</sup> After *Lear*, patentees attempted to use explicit contractual provisions to prevent validity challenges, but courts struck these clauses down.<sup>39</sup> Still, before *MedImmune*, unless a licensee stopped performing its obligations under the license, patentees who did not sue a licensee were unlikely to face a validity challenge because invalidity is an affirmative defense.<sup>40</sup> However, after *MedImmune*, patentees are less assured of their ability to use licenses to decrease the risk of validity challenges.<sup>41</sup>

#### B. *Lear, Inc. v. Adkins*

In *Lear, Inc. v. Adkins*,<sup>42</sup> Adkins, an inventor, entered into a licensing agreement with Lear, Inc., under which Lear could use Adkins's invention, even though Adkins had not yet obtained a patent for it.<sup>43</sup> At first, Adkins had trouble obtaining a patent and Lear, believing that Adkins's patent would not be granted, stopped paying royalties to Adkins.<sup>44</sup> However, Adkins's patent was subsequently granted and he immediately sued Lear, arguing that failure to pay royalties was a breach of contract.<sup>45</sup> The case went up on appeal to the Supreme Court of California, which concluded that the doctrine of licensee estoppel barred Lear from questioning the validity of Adkins's

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<sup>36</sup> If an alleged infringer loses an infringement suit, it must pay the costs of litigation and damages. However, if an alleged infringer prevails, it is free to use the allegedly infringing subject matter without paying any damages. Thus, the costs of prevailing can be viewed as a one-time royalty. The method of computing damages for infringement based on a hypothetical reasonable royalty rate underscores this concept. See ROBERT PATRICK MERGES & JOHN FITZGERALD DUFFY, *PATENT LAW AND POLICY: CASES AND MATERIALS* 966–86 (5th ed. 2011).

<sup>37</sup> See 2 SCHLICHER, *supra* note 24, § 12:20.

<sup>38</sup> See *infra* Part I.B.

<sup>39</sup> See *infra* Part I.C.

<sup>40</sup> 35 U.S.C. § 282(b) (2012); see also *infra* Parts II.A, II.B.

<sup>41</sup> See *infra* Part II.C.

<sup>42</sup> 395 U.S. 653 (1969).

<sup>43</sup> *Id.* at 658. Under the agreement, Lear promised to pay Adkins royalties for the use of his invention but the parties agreed that if Adkins was not granted a valid patent for his invention or if the patent was held invalid then Lear could terminate the agreement. *Id.* at 657.

<sup>44</sup> *Id.* at 658–59.

<sup>45</sup> *Id.* at 660.



patent.<sup>46</sup> The Supreme Court of the United States vacated the California court's decision<sup>47</sup> and struck down the doctrine of licensee estoppel, which it had previously endorsed.<sup>48</sup> In so holding, the Court balanced the strong federal policy of promoting the full and free use of ideas that are truly in the public domain<sup>49</sup> with common law contract principles, and held in favor of the former.<sup>50</sup> In favoring federal patent policy, the Court noted that licensees are often the only parties with the incentive to challenge the validity of a patent, and through this decision, the Court sought to unmuzzle licensees' ability to do so.<sup>51</sup>

### C. Gen-Probe Inc. v. Vysis, Inc.

In *Gen-Probe Inc. v. Vysis, Inc.*,<sup>52</sup> the Federal Circuit addressed *Lear* and its progeny and stated that *Lear* does not stand for granting every licensee in every circumstance the right to challenge the validity of the licensed patent.<sup>53</sup> The *Gen-Probe* court held that a nonrepudiating<sup>54</sup> licensee was unable to bring a declaratory judgment action challenging the validity of the patent under the Declaratory Judgment Act<sup>55</sup> because there was no actual controversy between the parties without a material breach of the agreement by the licensee.<sup>56</sup> In *Gen-Probe*, the two parties had entered into a license agreement as part of the settlement of prior

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<sup>46</sup> *Id.* at 661.

<sup>47</sup> *Id.* at 676.

<sup>48</sup> *Id.* at 670–71. The doctrine of licensee estoppel that the Court struck down was that which it invoked in *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827 (1950), *overruled in part by Lear*, 395 U.S. 653.

<sup>49</sup> *Lear*, 395 U.S. at 674 (“[E]nforcing this contractual provision would undermine the strong federal policy favoring the full and free use of ideas in the public domain.”).

<sup>50</sup> *Id.* at 668 (“The uncertain status of licensee estoppel in the case law is a product of judicial efforts to accommodate the competing demands of the common law of contracts and the federal law of patents. . . . [W]e must reconsider on their own merits the arguments which may properly be advanced on both sides of the estoppel question.”).

<sup>51</sup> *Id.* at 670–71.

<sup>52</sup> 359 F.3d 1376 (Fed. Cir. 2004).

<sup>53</sup> *Id.* at 1381.

<sup>54</sup> The Federal Circuit has said that in order to repudiate a license, the licensee must (1) stop paying royalties under the license agreement and (2) give notice to the licensor that it is challenging the validity of the licensed patent. See Ronald A. Bleeker & Michael V. O’Shaughnessy, *One Year After MedImmune—The Impact on Patent Licensing & Negotiation*, 17 FED. CIR. B.J. 401, 403 (2008) (citing *Studiengesellschaft Kohle, m.b.H. v. Shell Oil Co.*, 112 F.3d 1561, 1568 (Fed. Cir. 1997)).

<sup>55</sup> The Supreme Court has stated, “[t]he Declaratory Judgment Act provides that, ‘[i]n a case of actual controversy within its jurisdiction . . . any court of the United States . . . may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought.’” *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 126 (2007) (omissions and second alteration in original). The Court has also stated that an actual controversy under the Declaratory Judgment Act refers to the type of case or controversy that is justiciable under Article III of the Constitution. *Id.* at 126–27.

<sup>56</sup> *Gen-Probe*, 359 F.3d at 1382.

litigation involving other patents.<sup>57</sup> The day before filing the declaratory judgment action, the licensee informed the patentee that it would continue to pay royalties and fulfill its obligations under the license during litigation.<sup>58</sup> The Federal Circuit reasoned that the license between the parties formed a covenant in the patentee not to sue and held that without materially breaching the license the licensee did not face a reasonable apprehension of suit.<sup>59</sup> Without an apprehension of suit there is no actual controversy sufficient to bring a declaratory judgment action.<sup>60</sup>

#### D. MedImmune, Inc. v. Genentech, Inc.

Like *Gen-Probe*, *MedImmune, Inc. v. Genentech, Inc.*<sup>61</sup> involved the justiciability issue of whether a licensee who has not breached the license and continues to pay royalties under it, though under protest, has standing to seek a declaratory judgment that the underlying patent is invalid.<sup>62</sup> In *MedImmune*, the two parties had entered into a license covering a patent before the patent actually issued.<sup>63</sup> Upon issuance of the patent, the patentee wrote the licensee expressing its opinion that one of the licensee's products infringed the newly issued patent and stated that the patentee expected the licensee to pay royalties on the product.<sup>64</sup> Just like the licensee in *Gen-Probe*, the licensee in *MedImmune* brought a declaratory judgment action while continuing to pay royalties under the license.<sup>65</sup>

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<sup>57</sup> *Id.* at 1377.

<sup>58</sup> *Id.* at 1378–79.

<sup>59</sup> *Id.* at 1381 (“Upon entering into the agreement, [the patentee] promised not to sue [the licensee]. In other words, the license insulated [the licensee] from an infringement suit instituted by [the patentee]. This license, unless materially breached, obliterated any reasonable apprehension of a lawsuit . . .” (citations omitted)). The reasonable apprehension of suit requirement was the first prong of the Federal Circuit’s two-part test for determining whether an actual controversy existed. *See* *BP Chems. Ltd. v. Union Carbide Corp.*, 4 F.3d 975, 978 (Fed. Cir. 1993) (“Thus in patent litigation there has evolved a pragmatic two-part test for determining declaratory justiciability. There must be both (1) an explicit threat or other action by the patentee, which creates a reasonable apprehension on the part of the declaratory plaintiff that it will face an infringement suit, and (2) present activity which could constitute infringement or concrete steps taken with the intent to conduct such activity.”). This test evolved after *Gen-Probe* to the “reasonable apprehension of imminent suit” test, *see* *Teva Pharm. USA, Inc. v. Pfizer, Inc.*, 395 F.3d 1324 (Fed. Cir. 2005), which was overturned in *MedImmune*, 549 U.S. at 132 n.11.

<sup>60</sup> *Gen-Probe*, 359 F.3d at 1382.

<sup>61</sup> 549 U.S. 118 (2007).

<sup>62</sup> *Id.* at 120–21.

<sup>63</sup> *Id.* at 121.

<sup>64</sup> *Id.* at 121–22.

<sup>65</sup> *Id.* at 122.

The Supreme Court addressed the question of whether a licensee's own actions—those of meeting its obligations under a license, which eliminates the imminent threat of harm<sup>66</sup>—may prevent an actual controversy and noted that when the threat of harm is from the government, a plaintiff is not required to expose himself to liability before bringing suit to challenge the constitutionality of the threat.<sup>67</sup> The Court extended this analysis to private party enforcement, noting that, while Supreme Court precedent on the issue as applied to non-governmental enforcement is rare, lower federal courts have consistently held that an actual controversy is created when a party's avoidance of imminent injury is coerced by a private party's threat of enforcement.<sup>68</sup> As a result of this analysis, the Court held that the licensee was not required to repudiate its license before bringing a declaratory judgment action seeking to invalidate the patent.<sup>69</sup>

## II. THE IMPACT OF *MEDIMMUNE*: FOLLOWING *MEDIMMUNE*, PATENT HOLDERS NEED MORE PROTECTION IN ORDER TO FOSTER INNOVATION AND PUBLIC DISCLOSURE OF IDEAS

Though the Supreme Court's analysis in *MedImmune* focused on justiciability, the Court had the opportunity to address *Lear* more explicitly because each case involved balancing the demands of patent policy with those of contract law.<sup>70</sup> By allowing a licensee to maintain

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<sup>66</sup> *Id.* at 128 (“Assuming (without deciding) that [the patentee] here could not claim an anticipatory breach and repudiate the license, the continuation of royalty payments makes what would otherwise be an imminent threat at least remote, if not nonexistent. As long as those payments are made, there is no risk that [the patentee] will seek to enjoin [the licensee's] sales. [The licensee's] own acts, in other words, eliminate the imminent threat of harm. The question before us is whether this causes the dispute no longer to be a case or controversy within the meaning of Article III.” (footnote omitted)).

<sup>67</sup> *Id.* at 128–29 (“Our analysis must begin with the recognition that, where threatened action by *government* is concerned, we do not require a plaintiff to expose himself to liability before bringing suit to challenge the basis for the threat—for example, the constitutionality of a law threatened to be enforced. The plaintiff's own action (or inaction) in failing to violate the law eliminates the imminent threat of prosecution, but nonetheless does not eliminate Article III jurisdiction.”).

<sup>68</sup> *Id.* at 130 (“Supreme Court jurisprudence is more rare regarding application of the Declaratory Judgment Act to situations in which the plaintiff's self-avoidance of imminent injury is coerced by threatened enforcement action of a *private party* rather than the government. Lower federal courts, however (and state courts interpreting declaratory-judgment acts requiring ‘actual controversy’), have long accepted jurisdiction in such cases.”).

<sup>69</sup> *Id.* at 137. In addition to holding that a licensee does not have to repudiate the license in order to bring a declaratory judgment action, the Court also overturned the Federal Circuit's “reasonable apprehension of imminent threat” test, under which *Gen-Probe* was decided. *Id.* at 132 n.11. Finding that test too restrictive, the Court stated the proper test to be whether “under all the circumstances” the facts alleged show a substantial controversy. *Id.* at 127.

<sup>70</sup> See Bleeker & O'Shaughnessy, *supra* note 54, at 426 (“Like *Lear*, *MedImmune* also presented a choice between the competing demands of contract and public policy and the Supreme Court could have chosen to re-adjust the balance in favor of contract.”); *see also*

the protection of the license and still have standing to bring a declaratory judgment, *MedImmune* implicitly extends *Lear*'s holding favoring unencumbered validity challenges.<sup>71</sup> By extending *Lear* and abrogating another bar to validity challenges, the concerns addressed by commentators and the Federal Circuit prior to *MedImmune* are ripe for reconsideration.<sup>72</sup> Furthermore, *MedImmune* has heightened these concerns by altering the landscape of patent licensing.<sup>73</sup>

A. *Lear Did Not Consider Patent Law's Goals of Incentivizing Invention and Disclosing Ideas to the Public*

Even before the Federal Circuit was created,<sup>74</sup> one commentator had already called for a reexamination of the balance set forth in *Lear* that favored licensees.<sup>75</sup> Subsequently, the Federal Circuit has narrowed *Lear*'s holding,<sup>76</sup> but commentators still question how broadly it should be applied.<sup>77</sup> One prominent critique of *Lear* is that the Court did not

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Alfaro, *supra* note 19, at 1299–300 (“In the recently decided *MedImmune* case, the Supreme Court had the opportunity to clear up the confusion left behind by *Lear* in the area of invalidity-assertion bars.” (footnote omitted)).

<sup>71</sup> See Alfaro, *supra* note 19, at 1303 (“Furthermore, *MedImmune* at least extends *Lear*, thus reestablishing *Lear* as good law. By allowing a licensee to challenge the validity of a licensed patent while still paying royalties to the patentee—a clear extension of *Lear*'s holding that a patent licensee was not estopped from challenging the validity of its licensed patent—*MedImmune* resuscitates *Lear*'s abrogation of licensee estoppel.” (footnote omitted)). However, interestingly, the *MedImmune* Court stated that it was “express[ing] no opinion on whether a *nonrepudiating licensee* is similarly relieved of its contract obligation during a successful challenge to a patent's validity—that is, on the applicability of licensee estoppel under these circumstances.” *MedImmune*, 549 U.S. at 124.

<sup>72</sup> See *infra* Part II.C.

<sup>73</sup> See *infra* Part II.B.

<sup>74</sup> The United States Court of Appeals for the Federal Circuit was created by Congress in 1982. See generally MICHAEL E. & JANE B. TIGAR, FEDERAL APPEALS JURISDICTION AND PRACTICE § 2:12 (3d ed. 2013); Joseph R. Re, *Brief Overview of the Jurisdiction of the U.S. Court of Appeals for the Federal Circuit Under § 1295(A)(1)*, 11 FED. CIR. B.J. 651 (2002).

<sup>75</sup> McCarthy, Part II, *supra* note 19, at 568 (“[T]he time is ripe for the Supreme Court to recognize that in *Lear* it swept too broadly with the preemption brush.”).

<sup>76</sup> See Alfaro, *supra* note 19, at 1281 (“While the Federal Circuit initially affirmed the holding of *Lear*, it has since, at the very least, deviated from the ‘spirit’ of *Lear*. For instance, the Federal Circuit has overruled some of the post-*Lear* decisions allowing validity challenges, and it has distinguished away most of the policies set forth by *Lear*.” (footnote omitted)); Christian Chadd Taylor, Note, *No-Challenge Termination Clauses: Incorporating Innovation Policy and Risk Allocation into Patent Licensing Law*, 69 IND. L.J. 215, 246 (1993) (“The Federal Circuit directly reversed the *Lear* progeny of case law with respect to settlement agreements and consent decrees that prohibit licensee validity challenges. Though many circuits perceived the *Lear* policy of allowing licensees to challenge validity as restrictionless, the Federal Circuit indicated that this policy was indeed vulnerable to countervailing interests.”).

<sup>77</sup> See McCarthy, Part II, *supra* note 19, at 568 (“The *Lear* decision was based upon a policy of ‘eliminating obstacles to suit by those disposed to challenge the validity of a patent,’ but the ‘spirit of *Lear*’ cannot logically demand that any and all rules of contract law, patent law, and civil procedure be ignored to give licensees every possible incentive to challenge patent

adequately address two other important purposes of patent law: (1) to foster and reward invention and (2) to promote disclosure of such inventions for the public benefit.<sup>78</sup> After *Lear*, some commentators noted the importance of these purposes and questioned the economic efficiency of removing obstacles to a licensee's ability to challenge patent validity.<sup>79</sup> In other words, they argued that licensees should not be given "every incentive to challenge patent validity."<sup>80</sup>

Commentators noted that *Lear*'s holding burdened the security that encourages patentees to innovate.<sup>81</sup> Noting that the *Lear* Court's concern for innovation was based on a fear of monopolies, and questioning the Court's equation of a patent to a monopoly,<sup>82</sup> one commentator argued that the Court's emphasis on the free competition of ideas focused detrimentally on patent-antitrust cases from the World War I era, which almost always favored antitrust policy over patent policy, and ignored the value of patents in fostering innovation.<sup>83</sup> Bearing on such criticism was the fact that concern for promoting innovation became pronounced after economic retraction in the United States during the late 1970s and early 1980s.<sup>84</sup> Even just five years after

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validity." (footnote omitted) (quoting *Blonder-Tongue Labs., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 345 (1971)).

<sup>78</sup> Rooklidge, Part II, *supra* note 15, at 15–16. Rooklidge also notes that these two purposes came directly from the Constitutional grant while the Supreme Court hinted that the third—promoting free competition of ideas and limiting a patent's monopoly power—had its root in antitrust laws. *Id.*

<sup>79</sup> See Goldstucker, *supra* note 2, at 156 ("[E]limination of the use of no-challenge clauses does more harm than good. . . . Such injury to the patent system harms the policy of promoting invention and reduces both competition and technological advancement."); Taylor, *supra* note 76, at 253–54 ("Enforcing no-challenge termination clauses would make the efficient tool of licensing even more efficient, and would be a feasible step towards adjusting the legal system to maximize American economic strength."); see also William C. Rooklidge, *Licensee Validity Challenges and the Obligation to Pay Accrued Royalties: Lear v. Adkins Revisited (Part III)*, 69 J. PAT. & TRADEMARK OFF. SOC'Y 63, 87–88 (1987) [hereinafter Rooklidge, Part III] ("Eliminating the prospect of a licensee using the benefits of the license to challenge the validity of a licensed patent encourages the patent owner to license the invention. . . . [I]t stimulates inventive activity by guaranteeing the inventor a return for his efforts and disclosure.").

<sup>80</sup> See *supra* note 77.

<sup>81</sup> See Rochelle Cooper Dreyfuss, *Dethroning Lear: Licensee Estoppel and the Incentive to Innovate*, 72 VA. L. REV. 677, 686–87 ("[*Lear*'s] broader implications, however, caused concern because they left inventors uncertain about their rights to exploit discoveries and severely diminished the impetus to innovate."); Goldstucker, *supra* note 2, at 156 ("In sum, *Lear*'s elimination of the use of no-challenge clauses does more harm than good. The patent system is possibly injured when licensees are allowed to bring offensive patent validity challenges. Such injury to the patent system harms the policy of promoting invention and reduces both competition and technological advancement." (footnote omitted)).

<sup>82</sup> See Rooklidge, Part II, *supra* note 15, at 15 n.222.

<sup>83</sup> See *id.* at 15–16.

<sup>84</sup> See *id.* at 16; see also Dreyfuss, *supra* note 81, at 677–78; Amber L. Hatfield, Note, *Life After Death for Assignor Estoppel: Per Se Application to Protect Incentives to Innovate*, 68 TEX. L. REV. 251, 251–55 (1989).

*Lear*, in *Kewanee Oil Co. v. Bicron Corp.*,<sup>85</sup> the Supreme Court recognized the importance of providing patent holders with exclusive rights to promote innovation.<sup>86</sup> Today, the concern for innovation is no less important than it was in the 1970s and 1980s.<sup>87</sup>

The basic formulation of why patent rights foster innovation is that the exclusive right granted in a patent provides the economic incentive to invest in research and development.<sup>88</sup> However, for this *quid pro quo*<sup>89</sup> to function properly, inventors need to be confident that their rights will be secure.<sup>90</sup> Such confidence is fundamental to providing this incentive to innovate.<sup>91</sup> By providing more motivation and opportunity for licensees to challenge patent validity, *Lear* has encumbered this security,<sup>92</sup> threatening innovation, a purpose of the patent system that *Lear* failed to discuss. While holders of improperly granted patents should not have the right to protection of the invalid patent, there must be a balance between protecting valid patents and encouraging validity challenges to weed out invalid patents. Allowing a licensee to use the threat of litigation while protected from a suit of infringement seems to be an unfair tip of the scale.

Lack of patent security also hinders public disclosure of ideas and inventions because without security, inventors are more likely to turn to

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<sup>85</sup> 416 U.S. 470 (1974).

<sup>86</sup> *Id.* at 480 (“The stated objective of the Constitution in granting the power to Congress to legislate in the area of intellectual property is to ‘promote the Progress of Science and useful Arts.’ The patent laws promote this progress by offering a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research, and development. The productive effort thereby fostered will have a positive effect on society through the introduction of new products and processes of manufacture into the economy, and the emanations by way of increased employment and better lives for our citizens.”).

<sup>87</sup> See Dreyfuss & Pope, *supra* note 2, at 1006 (“The [*MedImmune*] decision could lead courts to revisit *Lear*, *Brulotte*, and the other 1960s cases expressing distrust with state law that touches on innovation policy. *Lear* and *Brulotte* were likely misguided when they were decided and they are certainly out of step with current economic understanding and business practices.”). The Supreme Court has also recognized that the policy of stimulating invention “runs no less deep” than the policy of free competition. *Dawson Chem. Co. v. Rohm & Haas Co.*, 448 U.S. 176, 221 (1980).

<sup>88</sup> See *supra* note 86; see also SCHLICHER, *supra* note 24, § 2:10.

<sup>89</sup> See Dreyfuss, *supra* note 81, at 733–34 (“Under the patent system, the *quid pro quo* for the exclusive right of a patent is that the invention be fully described in specifications publicly filed in the patent office. By informing others of what has already been discovered, these filings permit researches to avoid duplication of effort, provide a foundation upon which further developments can be made, and enable competitors to prepare their facilities for the time when the patent will expire.” (footnotes omitted)).

<sup>90</sup> See *id.* at 679–82.

<sup>91</sup> See Goldstucker, *supra* note 2, at 154–55 (“It must be noted that one major goal of patent policy is to ensure that inventors can effectively exploit valid patents and therefore reap the rewards of their innovations. This fundamental incentive to invent is seriously skewed if licenses are under constant siege with no assurance of finality.” (footnote omitted)).

<sup>92</sup> *Id.*

trade secrets to protect their rights, keeping their ideas hidden,<sup>93</sup> instead of seeking patent protection, which discloses the idea to the public.<sup>94</sup> By removing burdens to challenging validity, *Lear* made patentees less secure and made trade secrets more attractive.<sup>95</sup> Turning to secrecy to protect inventions severely limits the disclosure of useful information to the public,<sup>96</sup> limits licensing of inventions for the public use,<sup>97</sup> and restricts other inventors from building upon the disclosure of information to make innovative improvements.<sup>98</sup> Moreover, unlike patents, which expire, trade secrets lack any term limit so their secrecy can remain for as long as the inventor wishes.<sup>99</sup> The patent system, on the other hand, promotes disclosure of ideas to the public—both for immediate improvement and eventual unrestricted use after the patent term expires<sup>100</sup>—and encourages licensing.<sup>101</sup>

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<sup>93</sup> *Id.* at 157 (“Under the law of trade secrets, the inventor protects his invention by keeping his discovery secret, ensuring that the invention is never revealed to the public.”).

<sup>94</sup> *See id.* (“[A] policy denying private parties the ability to negotiate no-challenge clauses in licensing agreements discourages people from applying for patents and makes them reluctant to disclose their inventions. Inventors have begun to look to other areas of the law to protect their rights to their inventions. One such area of law is trade secrets.” (footnotes omitted)); Treadway, *supra* note 13, at 321 (“Unpredictable laws force firms to look away from those laws to more predictable measures to protect their interests. It is generally regarded that weakened patent protection would force firms to look to secrecy instead of patents.” (footnote omitted)).

<sup>95</sup> *See* Goldstucker, *supra* note 2, at 156.

<sup>96</sup> *See, e.g., id.* at 157 (“However, this turn toward trade secret protection is, in many ways, not in the public’s best interest. Trade secret protection in lieu of patent protection severely limits disclosure and licensing of inventions.”); Treadway, *supra* note 13, at 321 (“Inventors who opt to guard their clearly patentable inventions through secrecy instead of patents frustrate and undermine federal patent law because the fundamental goal is to promote disclosure.”).

<sup>97</sup> *See* Goldstucker, *supra* note 2, at 157 (“Trade secret protection in lieu of patent protection severely limits disclosure and licensing of inventions.”). Goldstucker also notes that the few licenses that are granted trade secret protection will not adequately disclose the invention and “therefore the public cannot improve upon them. This certainly does not achieve one of the enumerated goals of the patent system.” *Id.* (footnote omitted).

<sup>98</sup> *See* Dreyfuss, *supra* note 81, at 735 (“In contrast, trade secrets keep information hidden. The wheel must be continually reinvented because no one knows where other inventors have been or what they have discovered. As a result, research resources are misallocated as the same discoveries are made over and over, and insights are lost because the bases for them are hidden in confidential files.” (footnote omitted)).

<sup>99</sup> Goldstucker, *supra* note 2, at 157 (“Furthermore, unlike the law of patents, trade secrets have no term limits, so the inventor can withhold the technology from the public as long as desired.”).

<sup>100</sup> *See* Dreyfuss, *supra* note 81, at 733–35 (“By informing others of what has already been discovered, these filings permit researchers to avoid duplication of effort, provide a foundation upon which further developments can be made, and enable competitors to prepare their facilities for the time when the patent will expire. Furthermore, the patent expedites dissemination of the information discovered by the patentee because he is protected against free-riders by operation of law rather than by withholding crucial parts of his discovery. Finally, because improvements on the patent cannot be practiced without the permission of the patentee, the patentee becomes a clearinghouse for information concerning his innovation. This concentration of information, in turn, facilitates the continuation of research.” (footnotes omitted)); Goldstucker, *supra* note 2, at 158 (“On the other hand, the patent system protects

While the *Lear* Court was concerned about ensuring that ideas in the public domain remain free to use,<sup>102</sup> the Court's holding, by making secrecy more attractive, limits public disclosure of ideas to begin with. If inventors choose secrecy over patents, the goal of the patent system to promote public disclosure of ideas is frustrated.<sup>103</sup> Moreover, by increasing the risk of litigation faced by patentees, the costs of patenting will increase as well, both to licensees, in the form of higher royalty fees, and to the public, who will bear increased costs to the extent that licensees pass them on to their customers.<sup>104</sup>

### B. *MedImmune Has Made Licensing Less Attractive to Patentees*

Prior to *MedImmune*, the procedural issue of standing provided patentees with security against completely unfettered validity challenges brought by licensees in good standing.<sup>105</sup> Under *Gen-Probe*, the patentee knew that a nonrepudiating licensee could not bring a declaratory judgment action challenging patent validity.<sup>106</sup> However, this security

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inventions which ensure that inventions will remain in the public use. Furthermore, the public gains free use of patented inventions in twenty years when the patent expires.”).

<sup>101</sup> The patent system encourages licensing because it creates exclusive rights that can be licensed easily and to many parties. See SCHLICHER, *supra* note 24, § 11:2.

<sup>102</sup> *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969) (“Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain.”).

<sup>103</sup> *Dreyfuss*, *supra* note 81, at 691 (“If, on the other hand, the inventor chooses not to patent but rather to rely on state trade secret protection, the disclosure goal of the federal patent law will be frustrated.”); see also *Goldstucker*, *supra* note 2, at 158 (“[N]o-challenge termination clauses are favorable to the public as opposed to trade secret laws because the clauses empower the licensor through patent law, which requires disclosure and assures that inventions remain in the public domain.”).

<sup>104</sup> See *Rooklidge*, Part III, *supra* note 79, at 85 (“Even if no litigation ensues, the patent owner [who cannot use no-challenge clauses in license agreements] will have to charge a premium to its customers and charge a higher royalty to its licensees in the chance that litigation will occur. Once again, that royalty premium will be passed along to the customers.” (footnote omitted)).

<sup>105</sup> See *Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376 (Fed. Cir. 2004); *Studiengesellschaft Kohle, m.b.H. v. Shell Oil Co.*, 112 F.3d 1561, 1568 (Fed. Cir. 1997) (“However, 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.”); see also *Treadway*, *supra* note 13, at 317 (“What was really preventing licensees from bringing suit was a lack of a case or controversy. *Lear* did not decide that question because the licensee in *Lear* had discontinued royalty payments and a controversy already existed. After *Lear*, when licensees wanted to challenge patents without discontinuing royalty payments, the hurdle became jurisdiction, not licensee estoppel.”).

<sup>106</sup> *Gen-Probe*, 359 F.3d at 1382; see also Erik Belt & Keith Toms, *The Price of Admission: Licensee Challenges to Patents After MedImmune v. Genentech*, 51 BOS. B.J. 10, 11 (2007) (“So long as the license was in effect, the Federal Circuit reasoned, the licensee was shielded from litigation. Consequently, *Gen-Probe* required that the licensee forfeit the protection of the license to create declaratory judgment jurisdiction.”); Megan M. La Belle, *Standing to Sue in the*



was abrogated by the *MedImmune* decision.<sup>107</sup> By allowing a nonrepudiating licensee to challenge the validity of a patent it is licensing, the *MedImmune* decision has made the declaratory judgment action a valuable weapon for licensees to use in license negotiations.<sup>108</sup> In fact, many commentators have noted that *MedImmune* has dramatically shifted the licensing power in favor of the licensee.<sup>109</sup> This shift in power is derived from the licensee's increased ability to sue the patentee, or at least threaten to sue.<sup>110</sup> Faced with this threat, the patentee has an immense incentive to resolve the dispute without litigation (e.g., the costs of litigation; the potential that discovery will reveal business secrets; and especially potential patent invalidation). With respect to invalidation, the incentive to settle is so great because the patentee risks losing the validity of its patent against the world and not just against the licensee bringing litigation.<sup>111</sup> In addition, when a licensee brings a declaratory judgment action while maintaining its obligations under the license, the patentee cannot counterclaim for infringement, which makes it more likely that the patentee will choose to settle.<sup>112</sup>

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*Myriad Genetics Case*, 2 CAL. L. REV. CIRCUIT 68, 75 (2011) (“The [*Gen-Probe*] court reasoned that a non-repudiating licensee does not have a reasonable apprehension of suit because the patent holder *cannot* sue the licensee for infringement since the conduct is permitted under the license. Thus, after *Gen-Probe*, in order for a licensee in good standing to seek declaratory relief, it needed to breach the license agreement (for example by ceasing royalty payments), so as to create a reasonable apprehension of suit.” (footnote omitted)).

<sup>107</sup> *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007).

<sup>108</sup> Goldstucker, *supra* note 2, at 139 (“[T]he Supreme Court’s recent decision in *MedImmune* profoundly altered the declaratory judgment landscape. In *MedImmune*, the Supreme Court held that a patent licensee could seek a declaration on the validity or enforceability of a patent without breaching the licensing agreement. As a result of the *MedImmune* decision, the declaratory judgment action has now become a dangerous weapon in a licensee’s arsenal. A licensee no longer runs the risk of losing the license if he fails to invalidate the patent.” (footnotes omitted)).

<sup>109</sup> *See supra* note 2.

<sup>110</sup> Goldstucker, *supra* note 2, at 151 (“*MedImmune*’s basic legacy has been the liberalization of declaratory judgment standards. A patent holder has little power to prevent a licensee from bringing a declaratory judgment action of noninfringement or invalidity.”); *see also* Treadway, *supra* note 13, at 313–14 (noting that allowing suits like *Gen-Probe* to be brought, which is not possible due to *MedImmune*, “would put unfettered risk on patentees and licensors with a constant threat of suit”).

<sup>111</sup> Dreyfuss & Pope, *supra* note 2, at 982 (“In its effort to save the licensee from having to ‘bet the farm,’ the [*MedImmune*] Court shifted the entire litigation risk to the patent holder. Because of *Blonder-Tongue* and the demise of mutuality of estoppel, a declaration of patent invalidity is good against the world, and not just against the challenger. Accordingly, an adverse decision will destroy the entire income stream flowing from the patent. Knowing the risk, patent holders are much more likely to settle improvidently.” (footnote omitted)).

<sup>112</sup> *See* Jennifer L. Collins & Michael A. Cicero, *The Impact of MedImmune Upon Both Licensing and Litigation*, 89 J. PAT. & TRADEMARK OFF. SOC’Y 748, 751 (2007) (“Now, after the *MedImmune* decision, a licensee can have its cake and eat it, too, by continuing to pay royalties under protest in order to avoid an infringement claim, while seeking a declaratory judgment to invalidate the licensed patent. This leaves the licensor/defendant in a position of having no ability to file a counterclaim for infringement or breach of contract and therefore having no

C. *MedImmune Has Further Encumbered Innovation by Making the Patent System and Patent Licensing Scheme Less Attractive*

As noted above, *MedImmune* altered the landscape of license negotiations in favor of licensees and in doing so has generated new concern over the proper balance between protecting patentees and freeing invalid patents.<sup>113</sup> Following *Lear*, two primary concerns arose in response to the Court's holding that provided licensees with more incentive and ability to challenge patent validity: That inventors will be (1) less likely to innovate and (2) less likely to use the patent system.<sup>114</sup> Both concerns are amplified by *MedImmune's* impact on patent licensing.

Use of the patent system promotes innovation by providing rewards for invention,<sup>115</sup> but *MedImmune*, by shifting power in patent license negotiation towards licensees, has made licensing less attractive for patentees. Moreover, by increasing the threat of validity challenges, *MedImmune* has affected patent holders' assurance that they will be able to exploit their patents. This uncertainty undermines the incentive to invent and leaves patentees with no assurance of finality.<sup>116</sup>

The patent system not only provides incentives to innovate but also fosters public disclosure of inventions. By increasing the ability of licensees to bring declaratory judgment actions seeking to invalidate a patent, eroding a post-*Lear* bar that provided some protection for patentees,<sup>117</sup> the patentee is even less likely to grant licenses and more likely to view the costs of licensing as too great.<sup>118</sup> A patentee's choice not to license hinders the dissemination of the invention. When inventors are opposed to licensing, they are also more likely to turn to trade secrets or vertical integration of their invention, which hinders public disclosure to an even greater extent and is seldom the most economically efficient use of the invention.<sup>119</sup>

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leverage to settle a lawsuit and no remedy for incurring the cost of the lawsuit, unless the underlying license agreement contains some contractual provisions that are triggered by the filing of the claim for the declaratory judgment.”). For possible contractual provisions that may provide for some protection for the patentee based on breach of contract, see *infra* note 123.

<sup>113</sup> See Goldstucker, *supra* note 2, at 153 (“The erosion of patent holders’ rights in contract negotiation set forth in *Lear* and *MedImmune* prevents freedom of contract, undermines the goals of the patent system, and discourages the use of the patent laws to protect inventions.”).

<sup>114</sup> See *supra* note 78 and accompanying text.

<sup>115</sup> See Goldstucker, *supra* note 2, at 154.

<sup>116</sup> See *id.* at 154–55 (“This fundamental incentive to invent is seriously skewed if licenses are under constant siege with no assurance of finality.”).

<sup>117</sup> See *supra* Part II.B.

<sup>118</sup> See Treadway, *supra* note 13, at 323. The logic is simple and intuitive: Granting more licenses creates more licensees, which creates more parties who are able to challenge patent validity and thus exposes the patentee to more risk.

<sup>119</sup> *Id.* at 321–24.

Furthermore, *MedImmune* may cause patentees to seek revenue via infringement actions instead of licensing.<sup>120</sup> One commentator, who anticipates that *MedImmune* will lead to increased litigation, notes that proponents of *MedImmune*, like those of *Lear* before it, argue that removing bad patents benefits innovation by increasing competitiveness.<sup>121</sup> However, the commentator contends that the rule in *MedImmune* will increase litigation without necessarily improving the quality of patents; that this harm will have a larger negative impact on social welfare than any benefit from removing bad patents; and that *MedImmune* will decrease licensing activity.<sup>122</sup>

*MedImmune* has made both the patent system and patent licensing less attractive for inventors because it has further abrogated the protection from validity challenges that patent holders desire in order to feel secure that they can protect and exploit the exclusive rights that they invested their capital in to acquire. Following *Lear* and before *MedImmune*, commentators and courts had sought to reexamine the balance in *Lear* that favored unfettered validity challenges over providing patentees with the protection provided by negotiated agreements. Due to *MedImmune*'s impact in further encouraging validity challenges and the bearing this has on the balance of power in patent license negotiations, it is appropriate to reexamine the circumstances in which courts have found that the policy favoring validity challenges was actually outweighed by the need to uphold the protection provided by negotiated agreements.

### III. LEAR REVISITED: THE LICENSE-SETTLEMENT DICHOTOMY IN PRE-LITIGATION AGREEMENTS

While other methods to provide patentees with more security and ability to fairly negotiate licenses have been suggested,<sup>123</sup> extending the

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<sup>120</sup> See John W. Schlicher, *Patent Licensing, What To Do After MedImmune v. Genentech*, 89 J. PAT. & TRADEMARK OFF. SOC'Y 364, 368 (2007).

<sup>121</sup> See Liza Vertinsky, *Reconsidering Patent Licensing in the Aftermath of MedImmune*, 45 HOUS. L. REV. 1609, 1611–12 (2009) (noting the two sides of the debate over the impact *MedImmune* has had on innovation and social welfare and presenting a law and economics framework analyzing the debate). Without agreeing with either the proponents for *MedImmune*, who favor freeing bad patents, or the detractors of the decision, who argue that security in patent rights is necessary for innovation, the commentator used a law and economics framework to analyze *MedImmune*'s impact on social welfare. *Id.*

<sup>122</sup> *Id.* at 1655 (“*MedImmune* will increase litigation without necessarily improving patent quality, while decreasing the volume and increasing the cost of licensing. It suggests, furthermore, that these harms are likely to dominate any potential benefit of removing ‘bad patents.’ The rule change will have an uneven impact on certain categories of licensors and licensees, with a particularly negative impact on licensors of early stage technologies and budget-constrained innovators such as research institutions and individual inventors.”).

<sup>123</sup> See Bleeker & O’Shaughnessy, *supra* note 54, at 433–34; Collins & Cicero, *supra* note 112,

enforcement of settlement agreements is a logical place to start because the Federal Circuit and other circuits have already narrowed *Lear* when parties involved in patent litigation agree to a settlement.<sup>124</sup> Such courts noted that *Lear* did not involve a settlement and thus the public policy of enforcing settlements was absent from its analysis.<sup>125</sup> However, courts have not extended this same rationale to settlements entered into before litigation. This Note contends that, in order to provide patentees with sufficient protection, this extension can, and should, be made when parties to the agreement are in a preexisting license covering the patent in dispute. This Note argues that doing so would be in accord with the policy favoring the finality of settlements because agreements between preexisting parties to a license are more likely to accurately reflect bona-fide negotiation and agreement than license agreements between parties without a preexisting relationship.

A. *Pre-Litigation Settlement Agreements Can Be Identified by a Preexisting License Between Parties to the Agreement*

There are important differences between agreements between parties to a preexisting license and agreements between strangers<sup>126</sup> and though discerning the distinct characteristics of each circumstance and relationship may be intricate, it is not as difficult to identify the basic existence of a preexisting license.<sup>127</sup> Whenever parties enter into an

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at 752–55; Schlicher, *supra* note 120, at 388, 390–91; Alfred C. Server & Peter Singleton, *Licensee Patent Validity Challenges Following MedImmune: Implications for Patent Licensing*, 3 HASTINGS SCI. & TECH. L.J. 243, 417–38 (2011); Treadway, *supra* note 13, at 328, 330.

<sup>124</sup> See, e.g., *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362 (Fed. Cir. 2001); *Aro Corp. v. Allied Witan Co.*, 531 F.2d 1368 (6th Cir. 1976); see also *infra* Part III.B.

<sup>125</sup> *Flex-Foot*, 238 F.3d at 1368 (“In *Lear*, notably, the license did not contain, and was not accompanied by, any promise by the licensee not to challenge the validity of the patent. This distinguishing fact is meaningful because it implicates the important policy of enforcing settlement agreements and *res judicata*. Indeed, the important policy of enforcing settlement agreements and *res judicata* must themselves be weighed against the federal patent laws’ prescription of full and free competition in the use of ideas that are in reality a part of the public domain.”); *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348, 350 (Fed. Cir. 1988) (“*Lear*, however, did not involve a settlement of litigation, but only the right of a patent licensee to challenge the validity of the licensed patent. The enforcement of settlement of litigation involves another public policy totally absent in *Lear*: the encouragement of settlement of litigation and the need to enforce such settlements in order to encourage the parties to enter into them.”).

<sup>126</sup> See *infra* Part III.D.

<sup>127</sup> Determining whether two parties were in a license agreement at the time they entered a settlement agreement is relatively straightforward because it involves contract principles that are in widespread use. However, while determining the existence of a license is generally not complicated, determining the extent of a license agreement may not be as straightforward, for example when analyzing a licensee’s standing to sue a third party for infringement. See *Mentor H/S, Inc. v. Med. Device Alliance, Inc.*, 240 F.3d 1016, 1017 (Fed. Cir. 2001) (“To determine whether an agreement constitutes just an exclusive license or instead also transfers ‘all

agreement as preexisting parties to a license covering the same patent at issue, this Note advocates for referring to the agreement as a settlement.<sup>128</sup> These settlements may resolve a dispute over the validity of the patent,<sup>129</sup> a dispute whether a product would infringe the claims of the patent but for the license,<sup>130</sup> or a dispute over the terms of the current license. Distinguishing these settlements from license agreements addresses the *Rates Technology* court's concern that licensing agreements can easily be couched in terms of settlement agreements.<sup>131</sup>

B. *Case Law Suggests That No-Challenge Clauses Should Be Upheld  
When Contained in Settlement Agreements Between Parties to a  
Preexisting License*

Though no case has explicitly relied upon the fact that parties to a pre-litigation agreement were preexisting parties to a license, the case law concerning no-challenge clauses suggests that the relationship of the parties has mattered to courts. While federal courts treat no-challenge clauses in license agreements as virtually per se invalid,<sup>132</sup> the public

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substantial rights' in a patent, we must ascertain the intention of the parties and examine the substance of what was granted by the agreement.”)

<sup>128</sup> While this Note suggests that clarity can be derived from labeling a pre-litigation agreement between parties to a preexisting license as a settlement, one commentator notes that “[i]n a broad sense, every patent license is entered into in ‘settlement’ of patent litigation. A license that arises from the dismissal of pending litigation is clearly labeled part of a settlement, yet such a license is functionally the same as one entered into in return for refraining from the filing of a proposed suit.” McCarthy, Part II, *supra* note 19, at 555–56.

<sup>129</sup> See *Flex-Foot*, 238 F.3d at 1363–64 (settlement agreement resolved declaratory judgment action seeking to invalidate the patent).

<sup>130</sup> For example, Genentech sent MedImmune a letter stating its belief that a product MedImmune was manufacturing would infringe the claims of a licensed patent and thus royalties under the license should be owed. MedImmune responded with its declaratory judgment action. *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 121–22 (2007).

<sup>131</sup> *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 171–73 (2d Cir. 2012). This Note does not argue that the *Rates Technology* court erred in its holding to bar the validity challenge. The analysis of this Note would find the pre-litigation agreement a license and not a settlement because it was entered into between parties who were not in a preexisting license. This Note challenges the *Rates Technology* court's dismissal of the distinction between a pre-litigation settlement and a pre-litigation license as unimportant.

<sup>132</sup> See *Bendix Corp. v. Balax, Inc.*, 471 F.2d 149 (7th Cir. 1972); *Panther Pumps & Equip. Co., v. Hydrocraft, Inc.*, 468 F.2d 225 (7th Cir. 1972); *Plastic Contact Lens Co. v. W.R.S. Contact Lens Labs., Inc.*, 330 F. Supp. 441, 443 (S.D.N.Y. 1970); see also Goldstucker, *supra* note 2, at 160 (“However, in the post-*Lear* landscape, negotiated no-challenge provisions in licensing agreements have been abandoned, rejected by courts, and ignored by licensors . . . .”); *Rooklidge*, Part III, *supra* note 79, at 70 (“If there had been a no-challenge clause in the *Lear* license agreement, the Court undoubtedly would not have hesitated in striking it down. It is not surprising then that courts in post-*Lear* cases have uniformly interpreted the rationale of *Lear* to render patent license no-challenge clauses invalid and unenforceable.”); *Server & Singleton*, *supra* note 123, at 408 (“[T]o the knowledge of the authors, no court has challenged the

interest in upholding settlements has led some courts to estop parties from challenging validity when a settlement has occurred.<sup>133</sup> Though courts have primarily focused on the sufficiency of the litigation that was currently taking place, the case law reflects a distinction between agreements entered into between parties who had previously licensed the patent at issue in the dispute. In the three seminal cases involving no-challenge clauses in settlement agreements, *Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co.*,<sup>134</sup> *Flex-Foot, Inc. v. CRP, Inc.*,<sup>135</sup> and *Rates Technology Inc. v. Speakeasy, Inc.*,<sup>136</sup> the only decision that upheld the no-challenge clause was *Flex-Foot*, in which the settlement agreement was entered into between parties to a preexisting license.<sup>137</sup>

### 1. Settlement Agreements Containing No-Challenge Clauses

The first case addressing no-challenge clauses in settlement agreements, *Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co.*,<sup>138</sup> was decided about two years after *Lear*. In *Massillon-Cleveland-Akron Sign Co.*, the court held that a no-challenge clause in a pre-litigation agreement, entered into between parties who were not in a preexisting license,<sup>139</sup> was void and unenforceable.<sup>140</sup> In recognizing that *Lear* involved a balancing test, the court held that under the circumstances, the public policy favoring the settlement of disputes must yield to the federal policy favored in *Lear*.<sup>141</sup> The court found it “unimportant” to distinguish between whether the no-challenge clause was contained in a license agreement as opposed to a settlement agreement because such a distinction “would, in practice, be less than [sic] workable.”<sup>142</sup>

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consensus among the *Lear* progeny that a ‘no-challenge’ clause in the context of a typical licensing arrangement is unenforceable.”).

<sup>133</sup> See *Flex-Foot*, 238 F.3d 1362; *Aro Corp. v. Allied Witan Co.*, 531 F.2d 1368 (6th Cir. 1976).

<sup>134</sup> 444 F.2d 425 (9th Cir. 1971).

<sup>135</sup> 238 F.3d 1362 (Fed. Cir. 2001).

<sup>136</sup> 685 F.3d 163 (2d Cir. 2012).

<sup>137</sup> *Flex-Foot*, 238 F.3d at 1370.

<sup>138</sup> 444 F.2d 425.

<sup>139</sup> *Id.* at 425.

<sup>140</sup> *Id.* at 427 (“We think the rationale of *Lear* requires us to hold that the covenant . . . in the settlement agreement . . . not to contest the validity of MCA’s patent, is void on its face and unenforceable. It is in just as direct conflict with the ‘strong federal policy’ referred to repeatedly in *Lear*, as was the estoppel doctrine and the specific contractual provision struck down in that decision.”).

<sup>141</sup> *Id.* (“If the recognized policy favoring settlement of disputes might be hindered by our holding on this question, that policy, in our opinion, must give way to the policy favoring free competition in ideas not meriting patent protection.”).

<sup>142</sup> *Id.*

The same logic was followed by the United States Court of Appeals for the Second Circuit in *Rates Technology Inc. v. Speakeasy, Inc.*,<sup>143</sup> in which the court cited *Massillon-Cleveland-Akron Sign Co.*<sup>144</sup> for the proposition that it is unimportant to determine whether a pre-litigation agreement is a settlement or a license agreement.<sup>145</sup> The *Rates Technology* court struck down a no-challenge clause contained in a pre-litigation agreement between two parties who were not in a preexisting licensing relationship covering the underlying patent in dispute.<sup>146</sup> The court found it dispositive that the agreement was entered into prior to litigation and held that the licensee was not barred from challenging the patent's validity.<sup>147</sup>

The only opinion to uphold the validity of a no-challenge clause in the face of a validity challenge was the 2001 case of *Flex-Foot, Inc. v. CRP, Inc.*<sup>148</sup> In *Flex-Foot*, the Court of Appeals for the Federal Circuit held that a no-challenge clause in a settlement agreement, entered into after discovery between two parties to an existing license, barred the licensee from challenging the patent's validity.<sup>149</sup> The court noted that the licensee had twice before challenged the patent's validity before abandoning its challenge, both times via settlement and a licensing agreement.<sup>150</sup> While *Flex-Foot* is distinguishable from both *Massillon-Cleveland-Akron Sign Co.* and *Rates Technology* because *Flex-Foot* is the only case in which the agreement containing the no-challenge clause was entered into after some litigation had taken place, *Flex-Foot* is also distinguishable because it is the only case in which the parties had been in a license agreement with respect to the patent in dispute before the no-challenge clause was agreed to.

## 2. Settlement Agreements Without No-Challenge Clauses

Courts considering validity challenges in the absence of explicit no-challenge clauses have also noted when parties had previously licensed the patent at issue in the dispute. These cases suggest that the benchmark of discovery may not be as dispositive as the *Rates Technology* court found it to be, especially if explicit no-challenge clauses are negotiated for. What appears to matter more is the actions and relationship of the parties.

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<sup>143</sup> 685 F.3d 163 (2d Cir. 2012).

<sup>144</sup> 444 F.2d 425 (9th Cir. 1971).

<sup>145</sup> *Rates Tech.*, 685 F.3d at 173.

<sup>146</sup> *Id.* at 164.

<sup>147</sup> *Id.* at 171–72.

<sup>148</sup> 238 F.3d 1362 (Fed. Cir. 2001).

<sup>149</sup> *Id.* at 1370.

<sup>150</sup> *Id.*

In the 1976 case of *Aro Corp. v. Allied Witan Co.*,<sup>151</sup> the United States Court of Appeals for the Sixth Circuit held that the strong public interest in the settlement of litigation estopped a licensee from subsequently challenging the validity of a patent, even when the pre-litigation agreement did not contain a no-challenge clause.<sup>152</sup> In *Aro*, the parties had entered into a settlement after lengthy negotiations, which were initiated when the patentee sued the alleged infringer for infringement.<sup>153</sup> The *Aro* court advocated for a case-by-case, fact-driven analysis of the specific patent at issue and focused on the facts surrounding the settlement.<sup>154</sup> The court suggested that a clear public interest in upholding a settlement exists when there is no evidence of tangible negative effects from not challenging the patent.<sup>155</sup> The court also found it important that the parties negotiated the settlement freely and over many months, and noted that the licensee had the opportunity to challenge validity before settling, even though the settlement did not contain an explicit no-challenge clause.<sup>156</sup>

In *Warner-Jenkinson Co. v. Allied Chemical Corp.*,<sup>157</sup> the United States Court of Appeals for the Second Circuit held that a settlement agreement entered into after discovery did not bar a licensee from challenging the patent's validity during a subsequent dispute.<sup>158</sup> The settlement did not contain a specific provision that barred the licensee from subsequently challenging the patent's validity.<sup>159</sup> The court declined to use *Aro*'s case-by-case, fact-driven analysis to balance the interests of allowing a validity challenge, on the one hand, with the interests of settlements, on the other.<sup>160</sup> However, in dicta, the court

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<sup>151</sup> 531 F.2d 1368 (6th Cir. 1976).

<sup>152</sup> *Id.* at 1374 (“[W]e conclude that the public interest in the settlement of this litigation far outweighs any public interest to be served by providing [the licensee] with a second chance to litigate the validity of the soon-to-expire patent involved in this case.”).

<sup>153</sup> *Id.* at 1370. Under the settlement, the alleged infringer became a licensee. The use of the term settlement agreement in this case is an example of the difficulty that the *Rates Technology* court had—a difficulty that this Note seeks to offer guidance for addressing—in distinguishing between license agreements and settlement agreements. See *infra* Part IV.

<sup>154</sup> *Aro Corp.*, 531 F.2d at 1374 (“In balancing the public interest in settlement of lawsuits against that of removing invalid patents, we do not perceive the doctrinal standoff envisaged by [the licensee] in its reliance on *Lear*. Though neither policy can be said to be transcendent, the choice need not be draconian. Evidence, not monopolophobia, should control.”).

<sup>155</sup> *Id.* (“In the absence of such evidence respecting the true effect of the specific patent or patents involved in a particular case, the clear public interest in settlement of lawsuits may be expected to prevail.”).

<sup>156</sup> *Id.* at 1373 (“Having negotiated its settlement license at arm’s length over many months, during all of which time it was in court with full opportunity of challenging the patent involved, and having stipulated dismissal of its counterclaim, [the licensee] now seizes upon *Lear* as somehow providing it with an escape from its agreement and with a right to start all over again . . .”).

<sup>157</sup> 567 F.2d 184 (2d Cir. 1977).

<sup>158</sup> *Id.* at 185.

<sup>159</sup> *Id.* at 186.

<sup>160</sup> *Id.* at 188.



stated that if the settlement did contain an explicit prohibition from challenging validity, then a court may feel the need to uphold it.<sup>161</sup>

Recently, the Federal Circuit, in *Baseload Energy, Inc. v. Roberts*,<sup>162</sup> held that a no-challenge provision in a settlement agreement was not sufficiently explicit—it must have clear and unambiguous language stating that the specific challenge is barred—to bar the validity challenge.<sup>163</sup> Like *Aro*, the settlement agreement was entered into prior to discovery.<sup>164</sup> However, it was not clear whether the parties were in a preexisting relationship at the time of the agreement because the validity of a prior oral agreement was not adjudicated.<sup>165</sup> The licensee argued that, even if the terms of the no-challenge provision were explicit, the settlement agreement could not bar a validity challenge because the agreement was entered into under circumstances void of a dispute of patent validity or any litigation of that issue.<sup>166</sup> In response, the *Baseload* court stated, in dicta, that a dispute or litigation over patent validity, while pertinent, is not necessary in order to uphold the terms of a settlement agreement so long as it contains clear and unambiguous language.<sup>167</sup>

The dicta in *Warner-Jenkinson Co.* and *Baseload* suggest that no-challenge clauses may be upheld if they are unequivocal, regardless of whether discovery has taken place. This position, especially *Baseload*'s opinion that a prior dispute over patent validity is not necessary as long as a no-challenge clause is explicit, favors the finality of settlements to an extent greater than *Flex-Foot*, which happened to concern a no-challenge clause in an agreement entered into following discovery. Further, in *Aro*, the one case in which a settlement agreement estopped a validity challenge without a no-challenge clause, the agreement was entered into prior to litigation and the court seemed more concerned with the negotiation of the parties before the settlement than with the stage of litigation at which the settlement occurred. Thus, cases addressing settlements without no-challenge clauses either held the

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<sup>161</sup> *Id.* (“[I]f a settlement agreement contains an explicit prohibition on licensee suits during some future period . . . a court may feel that effect should be given to such provisions. However, the *Lear* decision militates against reading such provisions into a settlement agreement. Although one court has suggested that settlement-agreement licensee estoppels might be imposed through an objective, case-by-case balancing of the interests, we are unwilling to leave parties at the mercy of what inevitably would be an imprecise and uncertain test.” (citations omitted)).

<sup>162</sup> 619 F.3d 1357 (Fed. Cir. 2010).

<sup>163</sup> *Id.* at 1362–64.

<sup>164</sup> *Id.* at 1360–61.

<sup>165</sup> *Id.* at 1358–59.

<sup>166</sup> *Id.* at 1363.

<sup>167</sup> *Id.* (“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.”).

licensee estopped based on the negotiation and relationship of the parties prior to discovery or suggested that an explicit no-challenge clause would have estopped the validity challenge regardless of whether discovery had taken place.

C. *Critiquing the Rates Technology Court's Importance of Discovery*

In *Rates Technology*,<sup>168</sup> the Second Circuit analyzed case law and distinguished between different methods for a licensee and patentee to resolve disputes: litigation to final decision; entry of consent decree; private settlement during litigation; and private agreement before litigation.<sup>169</sup> In resolving holdings that upheld no-challenge clauses in settlements entered into during litigation and those that invalidated such clauses entered into before litigation, the court focused on the importance of the parties' opportunity to conduct discovery.<sup>170</sup> The court found the opportunity for discovery significant for two reasons: (1) it suggests that the alleged infringer had a full opportunity to assess the validity of the patent and (2) it provides evidence that there was a genuine dispute over the validity of the patent.<sup>171</sup> Commentators have also noted the distinction between settlements entered into prior to litigation and agreements entered into after some litigation.<sup>172</sup>

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<sup>168</sup> *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163 (2d Cir. 2012).

<sup>169</sup> *Id.* at 168–72.

<sup>170</sup> *Id.* at 172.

<sup>171</sup> *Id.* (“The fact that parties have conducted discovery seems to us significant in two respects. First, it suggests that the alleged infringer has had a full opportunity to assess the validity of the patent, and is therefore making an informed decision to abandon her challenge to its validity. Second, the fact that parties have conducted discovery is evidence that they had a genuine dispute over the patent’s validity, and that the patent owner is not seeking to prevent its monopoly from being challenged by characterizing ordinary licensing agreements as settlement agreements.”).

<sup>172</sup> See, e.g., Alfaro, *supra* note 19, at 1290 (“The *Lear* progeny courts enforced no-challenge clauses in settlement agreements entered into after extensive litigation or negotiation but invalidated no-challenge clauses in settlement agreements entered into with little or no litigation or negotiation. This extensive litigation versus little or no litigation understanding reconciles the post-*Lear* decisions, gives proper effect to the appellate courts’ interpretations of *Lear*, and provides a workable dividing line for the courts to apply.” (footnotes omitted)); McCarthy, Part II, *supra* note 19, at 562 (noting that the element of court involvement reconciles the differing holdings in *Massillon-Cleveland-Akron Sign Co. v. Golden State Adver. Co.*, 444 F.2d 425 (9th Cir. 1971) and *Aro Corp. v. Allied Witan Co.*, 531 F.2d 1368 (6th Cir. 1976)).

1. Discovery Is Not as Important to a Preexisting Licensee's Ability to Address the Validity of the Patent

While discovery on issues of patent validity can yield significant information, the nature of the patent system makes many important facts bearing on a patent's validity freely available without the need for discovery. Moreover, a licensee of the patent has the advantage of familiarity to help it understand whether the patent meets the requirements of patentability.

Any inquiry into assessing the validity of a patent must begin with the recognition that once a patent issues, it is entitled to a presumption of validity,<sup>173</sup> and a party attacking its validity in court must do so by clear and convincing evidence.<sup>174</sup> This presumption exists because a patent application must be prosecuted<sup>175</sup> before the Patent and Trademark Office before the patent is issued.<sup>176</sup> The history of this prosecution, including any concerns raised about the validity of the patent, is available to the public.<sup>177</sup> Therefore, even before discovery, a party seeking to challenge the validity of a patent has access to some material information that bears on the susceptibility of the patent's validity,<sup>178</sup> and has access to the most important document concerning patent validity: the patent application itself.<sup>179</sup> Moreover, a licensee uses the patented subject matter and thus has physical possession of it, which provides even more insight into determining the patent's validity. In order to further understand why discovery is not as critical in patent validity disputes as it is in other cases that a federal court may encounter,<sup>180</sup> it is important to understand the reasons why a patent can be found invalid and why licensees of the patent have an advantage in analyzing whether the patent is valid or not.

A patent is invalid if the subject matter of the patent, an invention or discovery, fails to meet any of following general requirements: (1) it

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<sup>173</sup> 35 U.S.C. § 282 (2012) ("A patent shall be presumed valid. . . . The burden of establishing invalidity of a patent or any claim thereof shall rest on the party asserting such invalidity."); see also *Roper Corp. v. Litton Sys., Inc.*, 757 F.2d 1266, 1270 (Fed. Cir. 1985) ("A patent is born valid.").

<sup>174</sup> See MERGES & DUFFY, *supra* note 36, at 1077–80.

<sup>175</sup> The patent application process, administered by the Patent and Trademark Office, is known as "prosecution." *Id.* at 50.

<sup>176</sup> See 3 MATTHEWS, JR., *supra* note 32, § 15:23; see also *Pfizer, Inc. v. Apotex, Inc.*, 480 F.3d 1348, 1359 (Fed. Cir. 2007) ("[D]eference to the decisions of the USPTO takes the form of the presumption of validity under 35 U.S.C. § 282.").

<sup>177</sup> See SCHLICHER, *supra* note 24, § 1:4.

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> It is worth noting that, although federal district courts hear patent validity cases, the Court of Appeals for the Second Circuit, which decided *Rates Technology*, does not have jurisdiction over patent validity appeals due to exclusive appellate jurisdiction over such disputes granted to the Court of Appeals for the Federal Circuit. 28 U.S.C. § 1295 (2012).

must be patentable subject matter,<sup>181</sup> (2) it must be useful,<sup>182</sup> (3) it must be novel,<sup>183</sup> (4) it must be nonobvious,<sup>184</sup> and the patent must include a (5) written description that fully describes the invention or discovery and (6) enables one to make and use it.<sup>185</sup> Many of these standards are judged from the point of view of an ordinary person of skill in the art.<sup>186</sup> A licensee is presumably such a person and is therefore in a good position to judge whether these requirements are met.

To invalidate a patent under the first requirement, a challenger must show that the patent is not within the extensive scope of patentable subject matter but rather that the invention or discovery falls under an exception to patentability because it is either a “law of nature,” “natural phenomena,” or an “abstract idea.”<sup>187</sup> The requirement of utility is also broad and relatively easy to satisfy,<sup>188</sup> although the patentee must disclose a specific and substantial utility.<sup>189</sup> A licensee is likely able to understand, based on its own use, whether the invention falls within the broad scope of patentable subject matter and has a specific and substantial utility. The licensee’s use similarly provides a better understanding of whether the patent’s written description fully describes the invention and is sufficient to enable one to make and use it without undue experimentation.<sup>190</sup> Further, since validity turns on the

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<sup>181</sup> 35 U.S.C. § 101 (“Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.”).

<sup>182</sup> *Id.* (“Whoever invents or discovers any new and *useful* process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.” (emphasis added)).

<sup>183</sup> *Id.* § 102.

<sup>184</sup> *Id.* § 103.

<sup>185</sup> *Id.* § 112. This section also requires the patentee to set forth a “best mode” for practicing the patent but failure to do so is not grounds for invalidating a patent. *Id.* § 282(b)(3)(A).

<sup>186</sup> The ordinary person of skill in the art is like the “reasonable person” standard in tort law. See Joseph P. Meara, *Just Who Is the Person Having Ordinary Skill in the Art? Patent Law’s Mysterious Personage*, 77 WASH. L. REV. 267, 267 (2002). It is the standard used under the written description requirement, see *Ariad Pharms., Inc. v. Eli Lilly & Co.*, 598 F.3d 1336, 1351 (Fed. Cir. 2010), enablement, see *Process Control Corp. v. HydReclaim Corp.*, 190 F.3d 1350, 1358 (Fed. Cir. 1999), novelty, see *SmithKline Beecham Corp. v. Apotex Corp.*, 403 F.3d 1331, 1342 (Fed. Cir. 2005), and, perhaps most importantly, nonobviousness, see 35 U.S.C. § 103.

<sup>187</sup> See *Ass’n for Molecular Pathology v. U.S. Patent and Trademark Office*, 689 F.3d 1303, 1324 (2012) (“The Supreme Court, however, has also consistently held that § 101, although broad, is not unlimited. The Court’s precedents provide three judicially created exceptions to § 101’s broad patent-eligibility principles: Laws of nature, natural phenomena, and abstract ideas are not patentable.” (citations omitted) (internal quotation marks omitted)).

<sup>188</sup> See *Juicy Whip, Inc. v. Orange Bang, Inc.*, 185 F.3d 1364, 1366 (Fed. Cir. 1999) (“The threshold of utility is not high: An invention is ‘useful’ under section 101 if it is capable of providing some identifiable benefit.”).

<sup>189</sup> See *In re Fisher*, 421 F.3d 1365, 1371 (Fed. Cir. 2005).

<sup>190</sup> See *Process Control Corp.*, 190 F.3d at 1358 (“The enablement requirement of 35 U.S.C. § 112, ¶ 1 requires that the specification adequately discloses to one skilled in the relevant art how to make, or in the case of a process, how to carry out, the claimed invention without undue experimentation.”).

interpretation of the written description found in the patent itself, and on whether it is comprehensible to a person of skill in the patent's art,<sup>191</sup> the necessity of discovery for a licensee is diminished.

Determining whether a patent meets the remaining two requirements of patentability, novelty and nonobviousness, requires evidence beyond the patent to a much greater extent than the other requirements above. Novelty requires that the invention was not known or used by others, patented, or described in a printed publication before the patent applicant invented it.<sup>192</sup> Further, the inventor loses the right to a patent if the invention was patented or described in a printed publication or was in public use or on sale more than one year prior to the filing date of the patent's application.<sup>193</sup> Nonobviousness requires that a person of ordinary skill in the relevant art would not find the invention obvious at the time of invention.<sup>194</sup> Both requirements concern references to the patent's subject matter that may not be contained in the patent itself or its prosecution history.<sup>195</sup> However, many of the references that may invalidate a patent are publicly available, primarily because novelty and nonobviousness, by general definition, concern whether the invention is a sufficiently new advancement over what was in the public domain before invention.<sup>196</sup> Thus, a licensee is in a good position to evaluate a patent's validity without the additional assistance of discovery. Armed with this knowledge, a licensee has a sense of whether or not it is truly giving up a meaningful opportunity to challenge the patent's validity by entering into a no-challenge clause, or whether it is merely giving up an opportunity that had little merit or value to pursue.

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<sup>191</sup> *See id.*

<sup>192</sup> 35 U.S.C. § 102(a) (2012).

<sup>193</sup> *Id.* § 102(b). This loss of right encourages inventors to file patent applications in a timely fashion. *See MERGES & DUFFY, supra* note 36, at 517. A patent applicant is also barred from obtaining a patent if he abandoned the invention, 35 U.S.C. § 119(c), or if another truly invented it, *see* 35 U.S.C. §§ 119(e), (f), (g).

<sup>194</sup> 35 U.S.C. § 103.

<sup>195</sup> For example, a patent for a widget might not contain a previously published printed publication describing the exact same widget, which would make the patent invalid as not novel.

<sup>196</sup> *See MERGES & DUFFY, supra* note 36, at chs. 5–7; *see also* *OddzOn Prods., Inc. v. Just Toys, Inc.*, 122 F.3d 1396, 1401–02 (Fed. Cir. 1997). Under 35 U.S.C. §§ 102 and 103 as amended by the Leahy-Smith America Invents Act of 2011, Pub. L. No. 112-29, 125 Stat. 284 (2011), which applies to patents applied for on or after March 16, 2013, the date at which novelty and nonobviousness is judged is not the date of invention but rather the date the patent application is first filed on. *See* Robert P. Merges, *Priority and Novelty Under the AIA*, 27 *BERKELEY TECH. L.J.* 1023, 1023–24 (2012).

## 2. Preexisting Licensees Have Already Had the Opportunity to Dispute the Patent's Validity When They Enter into the License

The *Rates Technology* court also emphasized that discovery provides evidence that the two parties had a genuine dispute over the patent's validity.<sup>197</sup> However, like its assertion that discovery offers a full opportunity to assess validity, the *Rates Technology* court did not expand on this contention.<sup>198</sup> Also, the court did not consider a very important distinction with respect to a dispute over patent validity between a patentee and an alleged infringer, on the one hand, and a dispute over patent validity between a patentee and a licensee to the patent, on the other: In the latter, the license already resolved a dispute over the patent's validity because license agreements are in essence settlements over patent validity.<sup>199</sup> While *Lear* mandates that the resolution represented by a license cannot estop a licensee from subsequently challenging the patent's validity, it is important to recognize that negotiation of a patent license does offer the opportunity to challenge the validity of the patent and that entering into it resolves an initial dispute over whether the patent is valid.

The fact that pre-litigation agreements between parties to a preexisting license already resolved a dispute over patent validity becomes important in light of *Lear*'s holding favoring the free use of ideas that are in reality part of the public domain.<sup>200</sup> Implicit in this holding is the preference for encouraging challenges to validity to occur as early as possible.<sup>201</sup> The fact that a licensee already had an

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<sup>197</sup> *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 172 (2d Cir. 2012).

<sup>198</sup> *Id.*

<sup>199</sup> See McCarthy, Part II, *supra* note 19, at 555–56 (“In a broad sense, every patent license is entered into in ‘settlement’ of patent litigation. A license that arises from the dismissal of pending litigation is clearly labeled part of a settlement, yet such a license is functionally the same as one entered into in return for refraining from the filing of a proposed suit. Even when no explicit threat of suit is made, the licensee agrees to the arrangement to buy ‘temporary peace’ from infringement litigation.”); *id.* at 562 (“Every license, however, is functionally a settlement of a potential suit for infringement, but after *Lear* a privately negotiated out-of-court license settlement lasts only so long as the licensee desires.”). While McCarthy comments on a license as a settlement of a potential suit for infringement, implicit in a suit of infringement is the alleged infringer’s right to assert invalidity as a defense. 35 U.S.C. § 282(b). Therefore, when a license settles a potential suit for infringement, the licensee is giving up the right to assert invalidity of the patent. The court in *Rates Technology*, 685 F.3d at 171, also recognized that patent licensing agreements are often entered into to settle a potential suit for infringement (“As the present case demonstrates, it is common for patent licensing agreements to be entered into after a patent owner makes an initial accusation of infringement.”).

<sup>200</sup> *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).

<sup>201</sup> See *Am. Equip. Corp. v. Wikomi Mfg. Co.*, 630 F.2d 544, 549 (7th Cir. 1980) (“If encouraging the swift and decisive removal of artificial barriers to the competition of ideas is the primary policy advocated in *Lear*, providing opportunities for recurrent, expensive, and duplicative litigation between the same parties is the least effective way to promote such a policy.”); *Atlas Chem. Indus. v. Moraine Prods.*, 509 F.2d 1, 6 (6th Cir. 1974) (“One of the

opportunity to challenge validity supports a rule that upholds a no-challenge clause in the subsequent agreement because it encourages the licensee to challenge validity at the earlier date or lose the ability to do so in the future.<sup>202</sup>

Even before entering a license agreement, and even after a party has become a licensee, the process of reexamination offers a party the opportunity to challenge a patent's validity. *Lear*'s detractors, who realized the importance of encouraging early validation challenges, noted that the reexamination process before the Patent and Trademark Office was not available at the time *Lear* was decided.<sup>203</sup> Although the reexamination process is more limited than litigation, it is a useful alternative and even a licensee can seek this procedure to challenge the validity of the licensed patent.<sup>204</sup> Not only is the presumption of validity in reexamination proceedings lower than the clear-and-convincing standard that a licensee faces at litigation,<sup>205</sup> but the relative cost is much lower than litigation as well,<sup>206</sup> which may temper the *Lear* Court's concern that licensees are the only parties with economic incentive to challenge patent validity.<sup>207</sup> In fact, the reexamination process has seen

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primary goals in *Lear* was to 'unmuzzle' licensees so that an early adjudication of invalidity could inure to the public interest."); see also McCarthy, Part II, *supra* note 19, at 563 ("The Court mandated in *Lear* that challengers to patent validity are to be encouraged to bring suit at as early a date as possible. Allowing a potential challenger to waive his initial opportunity to challenge does not serve this policy.").

<sup>202</sup> See Dreyfuss, *supra* note 81, at 720 ("Furthermore, by depriving licensees of a second chance to attack the patent when other infringers enter its markets, enforcement actually encourages 'earlier and more vigorous challenges to the validity of patents.'" (quoting *Am. Equip. Corp.*, 630 F.2d at 548)); McCarthy, Part I, *supra* note 12, at 495 ("If the policy of *Lear* is to encourage early challenges to patent validity, any rule that does not encourage licensees to challenge validity as early as possible is contrary to the spirit of *Lear*."); McCarthy, Part II, *supra* note 19, at 563.

<sup>203</sup> See Rooklidge, Part II, *supra* note 15, at 17 ("In addition to the change in the judicial attitude toward the relative importance of antitrust and patent policies, another development has cast doubt on the *Lear* focus on licensee validity challenges. Since 1981, any person may request the Patent and Trademark Office to reexamine a patent, that is, redetermine patentability in view of prior art." (footnote omitted)); Treadway, *supra* note 13, at 331 ("In fact, options like reexamination were not available when *Lear* was decided and may have led to the Court's concern.").

<sup>204</sup> See Nellie A. Fisher, *The Licensee's Choice: Mechanics of Successfully Challenging a Patent Under License*, 6 TEX. INTEL. PROP. L.J. 1, 45 (1997) ("The existence of a license agreement does not affect the licensee's right to file for reexamination of the licensed patent. Thus, the licensee may seek this procedure as one method of challenging the licensed patent." (footnotes omitted)).

<sup>205</sup> See Greg H. Gardella & Emily A. Berger, *United States Reexamination Procedures: Recent Trends, Strategies and Impact on Patent Practice*, 8 J. MARSHALL REV. INTEL. PROP. L. 381, 388 n.67 (2009).

<sup>206</sup> 37 C.F.R. § 1.20(c) (2013); see also Treadway, *supra* note 13, at 331 ("[Reexamination] is a less expensive alternative to litigation and provides benefits to both sides.").

<sup>207</sup> See Rooklidge, Part II, *supra* note 15, at 17 ("The reduced cost of a validity challenge calls into question the *Lear* court's statement that '[l]icensees may often be the only individuals with enough economic incentive to challenge the patentability of the inventor's discovery.'" (alteration in original) (quoting *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969))).

increasing use, partly because inter partes reexamination, which was created in 1999,<sup>208</sup> allows a challenger to participate in the reexamination.<sup>209</sup> Though reexamination is not a true substitute for litigation and is limited in its scope of review,<sup>210</sup> one commentator advocates that the patent system would be improved if parties are allowed to contractually limit validity challenges to reexamination.<sup>211</sup> Others have noted that inter partes reexamination has become an increasingly beneficial tool for challenging patent validity.<sup>212</sup>

When a licensee enters into a pre-litigation settlement agreement, it has, in essence, had three opportunities to challenge the patent's validity. The first opportunity is via reexamination,<sup>213</sup> the second opportunity occurs when entering into a license agreement, and the third is settlement of a dispute as a licensee. Furthermore, *MedImmune* allows an alleged infringer to challenge validity on its own terms via a declaratory judgment action,<sup>214</sup> giving the alleged infringer the procedural advantages afforded to the first filer.<sup>215</sup> Allowing licensees

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<sup>208</sup> See MERGES & DUFFY, *supra* note 36, at 1099.

<sup>209</sup> See Gardella & Berger, *supra* note 205, at 381–83.

<sup>210</sup> 35 U.S.C. §§ 302, 311 (2012).

<sup>211</sup> See Dmitry Karshedt, *Contracting for a Return to the USPTO: Inter Partes Reexaminations as the Exclusive Outlet for Licensee Challenges to Patent Validity*, 51 IDEA 309 (2011).

<sup>212</sup> See Tun-Jen Chiang, *The Advantages of Inter Partes Reexamination*, 90 J. PAT. & TRADEMARK OFF. SOC'Y 579, 579 (2008) ("It would not be unfair to say that, generally, *inter partes* reexamination is the most strategically advantageous avenue for an accused infringer seeking to invalidate a patent."); Gardella & Berger, *supra* note 205, at 381 ("While reexamination was used sparingly in the 1990s and early 2000s, there have been an increasing number of requests for reexaminations since that time due in large part to the perception that the new *inter partes* reexamination procedure is highly effective (from a challenger's perspective).").

<sup>213</sup> The differences between the two types of reexamination, *ex parte* and *inter partes*, also suggest a preference for early patent validity determinations. Any party can request an *ex parte* reexamination but has limited participation in the process. See MERGES & DUFFY, *supra* note 36, at 1101. However, the challenger is not estopped from subsequently challenging validity of the patent in court. *Id.* Conversely, a third party who challenges the validity of a patent via *inter partes* review is allowed to participate in the proceedings but is estopped from challenging the validity of the patent in court under any ground that it raised, or could have raised, in the *inter partes* reexamination. *Id.* at 1106; Gardella & Berger, *supra* note 205, at 383–84. Thus, under the reexamination process, a third party who actively participates in challenging validity is only allowed one opportunity to do so.

<sup>214</sup> One commentator suggests that it will become common practice for an alleged infringer to seek a declaration of invalidity before entering into a license. See Peter Jay, Note, *Removing Incentives for Technology Transfer: MedImmune v. Genentech*, 5 BUFF. INTELL. PROP. L.J. 69, 82 (2007) ("It may become the standard procedure to challenge a patent on its validity before accepting a license.").

<sup>215</sup> See Collins & Cicero, *supra* note 112, at 761–62. For a discussion on the advantages of declaratory judgment actions for alleged infringers, see Megan M. La Belle, *Patent Litigation, Personal Jurisdiction, and the Public Good*, 18 GEO. MASON L. REV. 43, 45 (2010) ("Declaratory judgment actions can be particularly effective because the alleged infringer chooses the forum and controls the timing of the suit, and these tactical advantages substantially increase the alleged infringer's chances of proving the patent invalid.").



multiple chances to challenge patent validity seriously hinders *Lear's* goal of encouraging early validation of patents in order to free ideas that are truly part of the public domain. Moreover, allowing multiple opportunities to contest validity, with no assurance of finality, hampers the security required by patentees to promote innovation. Upholding no-challenge clauses in agreements between a licensee and patentee—under which the licensee gives up the right to challenge the patent's validity for the third time—will encourage earlier validity challenges for the benefit of the public and the patentee.

D. *Pre-Litigation Agreements Between Parties to a Preexisting License Should Be Treated Differently than Pre-Litigation Agreements Between Strangers*

Courts have recognized the importance of the finality of disputes in upholding no-challenge clauses in settlement agreements.<sup>216</sup> While courts have used discovery as a benchmark to determine whether the policy favoring the finality of settlement is sufficiently implicated, the stage of litigation is less important when an agreement is entered between preexisting parties to a license covering the same patent in dispute. A preexisting license decreases the need for discovery<sup>217</sup> and is evidence of a settled dispute over patent validity.<sup>218</sup> Further, preventing multiple opportunities to challenge patent validity promotes *Lear's* preference for settling validity as early as possible. Thus, it makes sense to view agreements between parties to a license differently than agreements between strangers.

IV. A PROPOSAL FOR ANALYZING PRE-LITIGATION NO-CHALLENGE CLAUSES BETWEEN A LICENSEE AND PATENTEE IN A PREEXISTING LICENSE AGREEMENT

This Note seeks to present a framework for analyzing pre-litigation agreements between licensees and patentees. This analysis is three-fold: (1) this Note suggests that due to the concerns for innovation and public disclosure of ideas, discussed above,<sup>219</sup> patent holders need more protection from unfettered validity challenges following *MedImmune*; (2) this Note contends that, in order to provide such protection, jurisprudence favoring the finality of settlements over encouraging unfettered validity challenges should be reexamined and extended to

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<sup>216</sup> See *supra* Parts I.C, II.C.

<sup>217</sup> See *supra* Part III.C.1.

<sup>218</sup> See *supra* Part III.C.2.

<sup>219</sup> See *supra* Part II.

cover circumstances prior to litigation in which upholding the settlements of disputes is sufficiently important; and (3) this Note argues that when parties to a preexisting license enter into an agreement, whether before or during litigation, the agreement should be called a settlement and accorded the deference of the policy favoring the finality of disputes. Thus, this Note maintains that no-challenge clauses in pre-litigation settlements—those between a preexisting licensee and patentee—should be upheld against subsequent challenges to the patent's validity.

A. *Argument for Upholding No-Challenge Clauses in Pre-Litigation Agreements Between a Licensee and Patentee in a Preexisting License Agreement*

In the aftermath of *MedImmune*, patentees need more protection of their exclusive rights in order to encourage robust and confident use of the patent system and patent licensing. Such use will incentivize invention and encourage the public disclosure of ideas. However, while promotion of these two purposes of federal patent law is important to catalyze innovation, it is also important to promote the third purpose of patent law: to encourage challenges of patent validity in order to ensure that ideas belonging to the public remain free for the public to use. Advancing the ultimate goal of patent law, to foster innovation, requires a careful balance between these purposes, and this Note contends that reexamination of this balance is appropriate following *MedImmune*.

Courts have recognized the important public policy favoring the finality of settlements and have upheld no-challenge clauses in settlement agreements. In these instances, courts have used the stage of litigation at which the settlement is entered into to determine whether favoring the finality of disputes outweighs federal patent policy favoring unfettered validity challenges. In doing so, courts have overlooked another way of determining when sufficient interest in the finality of disputes should outweigh federal patent policy: whether the parties to the agreement were in a preexisting license covering the underlying patent in dispute.

This Note argues that the presence of a preexisting license is important because (1) a licensee's familiarity with the patented subject matter gives it an advantage in assessing the patent's validity, and, (2) perhaps more significantly, the preexisting license is evidence of a genuine dispute of patent validity between the parties. These factors discount the need for discovery, which courts have recognized as an important stage in litigation to meet before allowing no-challenge clauses to attach with force. When the challenger of patent validity is a licensee to the patent, discovery, whether deemed as providing

information bearing on patentability or as providing evidence that validity was contemplated, is not as critical.<sup>220</sup>

Since licensees generally do not need discovery in order to have a meaningful opportunity to assess whether to challenge a patent's validity, there is less concern that upholding no-challenge clauses in pre-litigation settlements between parties to a preexisting license will greatly encumber the federal patent policy of encouraging challenges to invalidate patents covering ideas that truly belong in the public domain. In fact, upholding and enforcing no-challenge clauses between parties to a preexisting license encourages earlier validity challenges by forcing the licensee to assess whether to challenge the patent's validity before agreeing to a no-challenge clause, as opposed to allowing a licensee to hold onto the ability to challenge validity. Providing a patentee the ability to bargain for a no-challenge clause before litigation not only encourages earlier validity challenges but also allows the patentee to obtain for such future security without going through discovery. It is inefficient to require patentees to litigate past the stage of discovery in order to unlock the ability to negotiate for an enforceable no-challenge clause. When compared to the likely amount of additional information that discovery may yield and any additional imprimatur of an actual dispute over validity that such an undertaking may provide, the costs of discovery are outweighed by the incentive to foster earlier validity challenges.

Moreover, if patentees cannot bargain for an enforceable no-challenge clause prior to discovery, licensees will always be able to use the threat of discovery as a powerful negotiating tool to affect the resolution of disputes between the parties. Following *MedImmune*, licensees can raise this threat prior to any litigation between the parties merely by threatening to file a declaratory judgment action seeking to invalidate the patent. Given the more advantageous negotiating position that this gives licensees, it is more likely that inventors will refuse to license their patents or turn to trade secrecy to protect their inventions.<sup>221</sup> This seriously undermines innovation and public disclosure of ideas.<sup>222</sup> Allowing an alleged infringer to avoid infringement litigation by accepting a license and then using the threat of a declaratory judgment, including discovery, in renegotiation is not only unfair but will simply lead to either inventors avoiding the patent system and patent licensing, which frustrates the goals of patent law to encourage innovation and disclosure of ideas, or to patentees accepting licenses at lower rates, which hinders the incentive to innovate while

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<sup>220</sup> See *supra* Part III.C.

<sup>221</sup> See *supra* Part II.C.

<sup>222</sup> *Id.*

also preserving the status of a patent that may be invalid.<sup>223</sup> Any rule that does not encourage earlier patent validity challenges is counter to *Lear's* recognition of the important public interest in freeing ideas that are really in the public domain.<sup>224</sup>

B. *No-Challenge Clauses in Pre-Litigation Agreements That Resolve a Declaratory Judgment Action Brought by a Licensee Against the Patentee Are More Suspect*

The argument for upholding no-challenge clauses in pre-litigation settlements is even stronger when the licensee is threatening a declaratory judgment action to challenge the validity of the patent. In such a case, when the licensee initiates the dispute but agrees to a settlement, thereby giving up the ability to challenge validity in the future, it is likely that the licensee used the threat of litigation in order to bargain for more favorable terms. In exchange for a lower royalty rate, the licensee may be willing to accept a no-challenge clause. If that clause is disregarded, the licensee, who bargained for a lower rate, could continually threaten litigation—which would impose a high cost on the patentee—in order to renegotiate the terms of the license. Not only would this run counter to *Lear's* preference for early validity challenges, but if a licensee is willing to give up the future ability to challenge validity in order to gain lower royalty rates, then the licensee should be forced to abide by the bargain.

C. *Addressing the Concern That Patentees Will Simply Demand a No-Challenge Clause in a Second License Agreement*

The primary critique of this Note's proposal is that by upholding no-challenge clauses in agreements between preexisting parties to a license, the patentee will simply forgo inclusion of a no-challenge clause in a license agreement and then turn around and demand one in a

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<sup>223</sup> See Treadway, *supra* note 13, at 320 ("There is also little downside for a potential infringer and non-licensee to take a license and then bring suit. *MedImmune* may allow licensees to 'challenge the patent while simultaneously enjoying its benefits, protected by the license from an infringement action by the licensor and competition by non-licensees.' It is hard to resist the cliché of having one's cake and eating it, too. Licensees who are capable of bringing suit today will likely threaten to sue at the very least in order to prompt renegotiation. Potential licensees may be in an even better position because they can use the license first as a shield by taking the license in the first place, and later, as a very sharp sword, by renegotiating for an even better license. The benefit to licensees may be great, but the loss realized by diminished levels of invention, licensing, and investment may not be worth that cost." (footnote omitted) (quoting Brief for the Am. Bar Ass'n as Amicus Curiae Supporting Respondents at 3, *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007) (No. 05-608))).

<sup>224</sup> See *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).

subsequent agreement. While this behavior might be prevalent under the rule this Note proposes, this Note does not deem such an action as an inherent problem. The primary effect of allowing a patentee to ask for a no-challenge clause during license renegotiations is that the patentee has another provision that it can bargain for—not necessarily that a no-challenge clause will be included.<sup>225</sup> One commentator notes that the *MedImmune* Court was wrong to characterize patent licensing as inherently coercive<sup>226</sup> by overlooking that contracts are generally seen as voluntarily entered into by the parties.<sup>227</sup> Even without the availability of no-challenge clauses, both parties will negotiate for favorable provisions.<sup>228</sup> Upholding no-challenge clauses in renegotiated licenses will simply allow the licensee to gain more favorable terms, such as lower royalty rates, and providing more flexibility for private parties to negotiate will enhance the patent licensing system.<sup>229</sup> Moreover, upholding no-challenge clauses in renegotiated licenses will force licensees to consider challenging validity, which, as this Note argues, is in accord with the goal of patent law, recognized in *Lear*, to free ideas that are truly in the public domain as early as possible.

#### CONCLUSION

Upholding no-challenge clauses in pre-litigation settlement agreements between parties to a preexisting license not only addresses two concerns absent from *Lear*—that promoting validity challenges will decrease innovation and public disclosure of ideas—but also addresses *Lear*'s main concern—freeing ideas that are truly in the public domain—by encouraging earlier patent validity challenges. As *Lear* suggests, licensees should be encouraged to challenge patent validity, not to settle and avoid doing so, and enforcing no-challenge clauses in pre-litigation settlement agreements will do so by forcing licensees to

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<sup>225</sup> See Dreyfuss & Pope, *supra* note 2, at 1006 (“Rules that give licensing parties greater flexibility to structure their arrangements can make licensing more efficient, improve public access to new technologies, and enhance incentives to innovate.”).

<sup>226</sup> *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 128–31 (2007).

<sup>227</sup> See Lorelei Ritchie, *Reconciling Contract Doctrine with Intellectual Property Law: An Interdisciplinary Solution*, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 105, 142 & n.192 (2008).

<sup>228</sup> *Id.*; see also Goldstucker, *supra* note 2, at 156 (“Rules permitting flexibility in negotiation will result in a greater degree of licensing activity because negotiating parties will not be constrained by restrictions. When allowed to freely negotiate, parties will set the terms of the contract to reflect their perception of the strength of the patent, the likelihood of successful suit brought by the patent holder, the potential use and value of invention, and other business factors not mentioned.”).

<sup>229</sup> See Goldstucker, *supra* note 2, at 159 (“A patent will be licensed more frequently if parties are allowed to freely contract under patent law. More frequent licensing increases the dissemination of information on a particular patent, a result in line with patent policy.”).

either challenge or give up the right to do so in the future. This policy of encouraging licensees to seek final decrees of invalidity is also in accord with the public policy favoring the finality of settlements that has led courts to uphold no-challenge clauses in settlement agreements entered into during litigation. Therefore, in order to encourage licensees to challenge validity sooner rather than later and to provide patentees with an assurance of finality in disputes over patent validity, it is appropriate to recognize that the public policy interest in pre-litigation settlement agreements is sufficiently important to outweigh the federal patent policy favoring unfettered validity challenges. Thus, no-challenge clauses in pre-litigation settlement agreements should be upheld and enforced.