

The Impacts of *Seagate* and *MedImmune* on Patent Litigation and Licensing

Ramsey M. Al-Salam
Perkins Coie LLP

1201 Third Avenue, Suite 4800
Seattle, Washington 98101
Telephone: (206) 359-6385
Email: RAlsalam@perkinscoie.com

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I. INTRODUCTION

In the last two years, almost every major patent decision could be characterized as diminishing the rights of patentees. These include decisions holding that prevailing patentees are not automatically entitled to an injunction¹; that a patentee is not entitled to damages for software copied abroad under 35 U.S.C. § 271(f)²; that the Federal Circuit's test for obviousness has been too rigid³; that a method claim is not infringed where different parties carry out different steps of the method, even if this "may in some circumstances allow parties to enter into arms-length agreements to avoid infringement"⁴; that claims directed to "signals" are not patentable subject matter⁵; that claims relating to mandatory arbitration in certain legal matters are not patentable subject matter⁶; that the doctrine of willful infringement does not create a duty for a potential infringer to get an opinion of counsel⁷; and that the Federal Circuit test for when a licensee or potential licensee may bring a declaratory judgment action patent⁸ was too strict. While each of these decisions is important, this paper focuses on the last two—the *Seagate* decision changing the standards for willful infringement and the *MedImmune* decision changing the standards for declaratory judgment actions.

II. THE NEW STANDARDS FOR WILLFULNESS— *In re Seagate Technology LLC*

A. The Pre-*Seagate* Law on Willfulness

A patent infringer is liable for damages "adequate to compensate for the infringement, but . . . no less than a reasonable royalty." 35 U.S.C. § 284. In addition, a court may award treble damages, and "in exceptional cases," may award attorneys' fees. *Id.*; 35 U.S.C. § 285. Courts have generally awarded increased damages and/or attorneys' fees where infringement has been "willful."

Prior to *Seagate*, a potential infringer with "actual notice of another's patent rights," had "an affirmative duty to exercise due care to determine whether or not he is infringing." *Underwater Devices Inc., v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389 (Fed. Cir. 1983), *overruled by In re Seagate Tech., LLC*, 497 F.3d 1360, 83 U.S.PQ.2d 1865 (Fed. Cir. 2007). "Such an affirmative duty includes, *inter alia*, the duty to seek and obtain competent legal advice from counsel *before* the initiation of any infringing activity." *Id.* at 1390 (citations omitted).

The law led to potential infringers obtaining written opinions of counsel so as to minimize any likelihood of a finding of willful infringement. This, in turn, led to

¹ *eBay, Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006).

² *Microsoft Corp. v. AT&T Corp.*, 127 S. Ct. 1746 (2007).

³ *KSR Int'l Co. v. Teleflex, Inc.*, 127 S. Ct. 1727 (2007).

⁴ *BMC Res., Inc. v. Paymentech, L.P.*, 498 F.3d 1373, 1381 (Fed. Cir. 2007).

⁵ *In re Nuijten*, 500 F.3d 1346 (Fed. Cir. 2007).

⁶ *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007).

⁷ *In re Seagate Tech. LLC*, 497 F.3d 1360 (Fed. Cir. 2007).

⁸ *MedImmune v. Genentech, Inc.*, 127 S. Ct. 764 (2007).

disputes concerning the scope of any waiver of privilege associated with reliance on an opinion of counsel. One of the disputes, for example, was whether relying on an opinion of in-house counsel waived any advice received from outside counsel. In *In re EchoStar Communications Corp.*, 448 F.3d 1294, 1299, 1302-03 (Fed. Cir.), *cert. denied*, 127 S. Ct. 846 (2006) the court held that such reliance did constitute a waiver, and also constituted a waiver of the work-product protection and attorney-client privilege for all communications between an attorney and client on the same subject matter, as well as any documents memorializing such communications. The waiver did not extend, however, to work product that was not communicated to an accused infringer. *Id.*

EchoStar did not resolve, however, the dispute as to whether reliance on an opinion of counsel waived advice received from *trial counsel*. In particular, patentees often demanded that the accused infringer provide any advice regarding the merits.

B. The *Seagate* Decision

In *Seagate*, the Federal Circuit addressed, en banc, the standards for willfulness, and the issue of waiver. See *In re Seagate Tech., LLC*, 497 F.3d 1360 (Fed. Cir. 2007). The court noted that the term “willfulness” was not unique to patent law, and has a “well-established meaning in the civil context.” *Id.* at 1370. Under copyright law, for example, willfulness is defined as a “reckless” disregard of the law. *Id.* Based on such precedent, the Federal Circuit created a two-part test for proof of willful patent infringement:

Accordingly, to establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent. . . . The state of mind of the accused infringer is not relevant to this *objective* inquiry. If this threshold objective standard is satisfied, the patentee must also demonstrate that this objectively-defined risk (determined by the record developed in the infringement proceeding) was either known or so obvious that it should have been known to the accused infringer. We leave it to future cases to further develop the application of this standard.

Id. at 1371 (emphasis added).

The court also held that the waiver created by reliance on opinion of counsel should not extend to trial counsel absent exceptional circumstances. In explaining its reasoning, the court noted that a willfulness claim in the complaint “must necessarily be grounded exclusively in the accused infringer’s pre-filing conduct.” *Id.* at 1374.

By contrast, when an accused infringer’s post-filing conduct is reckless, a patentee can move for a preliminary injunction, which generally provides an adequate remedy for combating post-filing willful infringement. A patentee

who does not attempt to stop an accused infringer's activities in this manner should not be allowed accrue enhanced damages based solely on the infringer's post-filing conduct. Similarly, if a patentee attempts to secure injunctive relief but fails, it is likely the infringement did not rise to the level of recklessness. . . . A substantial question about invalidity or infringement is likely sufficient not only to avoid a preliminary injunction, but also a charge of willfulness based on post-filing conduct.

Id. at 1374 (citation omitted).

C. The Ramifications of *Seagate*

The ramifications of *Seagate* are yet to be determined. In general, however, there is no longer an affirmative duty to seek an opinion of counsel. Many defendants may seek such an opinion. First, the law is unsettled and it could change again to require an opinion. Second, it cannot hurt to have an opinion. A party may always decide, later, whether to rely on the opinion. Finally, prior to *Seagate*, courts had struggled with the issue of whether a patentee could introduce into evidence the fact that a party did not get an opinion. At least one district court held that such evidence could be presented to a jury.⁹ *IMX, Inc. v. Lendingtree, LLC*, No. Civ. 03-1067-SLR, 2006 WL 38918, at *1 (D. Del. January 6, 2006). “The fact that no opinion of counsel on the issue of infringement was acquired by defendant may be considered by the trier of fact in its willful infringement analysis.” On the other hand, another district court held that the fact that a party had received an opinion, but refused to produce it in the litigation, could not be introduced. *See C. McKesson Info. Solutions, Inc. v. Bridge Med., Inc.*, 80 U.S.P.Q.2d 1222 (E.D. Cal. 2006) (granting motion *in limine*). Accordingly, simply obtaining an opinion might preclude the patentee from introducing any evidence as to the lack of opinion. The higher standards for willfulness are also likely to lead to more summary judgment motions on the issue. In particular, the Federal Circuit's standards appear to suggest that any substantial defense at trial eliminates any willful infringement, even if the defense was not known at the time infringement began. In particular, the Federal Circuit test requires proof of an “objective likelihood” that a person is infringing a valid patent, without regard to the parties' state of mind. Accordingly, if the defendant is able to identify any significant defenses on validity or infringement, it can presumably seek summary judgment on any claim of willful infringement.

The standards may also lead to additional motions for preliminary injunction. *Seagate* suggests that a party may waive its right to claim willfulness, at least with respect to post-filing conduct, if it has not sought a preliminary injunction.

⁹ These decisions followed the Federal Circuit's decision in *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337, 72 U.S.P.Q.2d 1560 (Fed. Cir. 2004), which held that adverse inference jury instructions, based on the failure of a defendant to obtain an opinion of counsel, or the failure of a defendant to produce an opinion of counsel, were improper. The Federal Circuit had not, however, provided any guidance on whether such evidence was admissible.

Finally, the *Seagate* decision should reduce, to some extent, arguments concerning waiver. *Seagate*'s separation of opinion and trial counsel will also likely lead to parties using opinion counsel less for litigation matters (so as to avoid any overlap).¹⁰

III. CHALLENGES TO PATENT RIGHTS BY LICENSEES— *MedImmune, Inc. v. Genentech, Inc.*

A. The *MedImmune* Decision

In *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007), the Supreme Court held that a patent licensee could challenge the validity of a patent, even when the licensee was in full compliance with the license agreement. Prior to the decision, courts had held that a licensee in compliance with an agreement was under no risk of being sued for patent infringement, and thus there was no “case or controversy” to support jurisdiction. The decision will affect the way license agreements are written and could lead to increased challenges of patents by patent licensees.

Article III of the Constitution limits the jurisdiction of the federal courts to resolving a “case or controversy.” The courts do not have jurisdiction to provide advisory opinions, or to resolve hypothetical disputes. This constitutional limitation was previously interpreted as prohibiting a court from exercising jurisdiction over a licensee’s request for a declaratory judgment that a licensed patent was invalid or not infringed if the licensee was in compliance with the license agreement. In particular, prior to *MedImmune*, the Federal Circuit had held that a plaintiff in a declaratory judgment action challenging the validity of the patent must have, among other things, a “reasonable apprehension” of being sued for infringement of the patent. *See Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376, 1380 (Fed. Cir. 2004), *abrogated, MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764, 166 L. Ed. 2d 604 (2007). A licensee in compliance with a license agreement has no “reasonable apprehension” of being sued; accordingly, there is an insufficient “case or controversy” to support jurisdiction.

In *MedImmune*, MedImmune had licensed from Genentech a patent relating to “chimeric antibodies” and a patent application based on the “coexpression of immunoglobulin chains in recombinant host cells.” 127 S. Ct. at 768. When the patent application issued as a patent, Genentech demanded that MedImmune pay royalties on its Synagis product. MedImmune paid the royalties but filed a declaratory judgment action asserting that the patent was invalid and unenforceable.

Consistent with the *Gen-Probe* decision, the district court dismissed MedImmune’s Complaint, and the Federal Circuit affirmed. *MedImmune, Inc. v. Genentech, Inc.*, 427 F.3d 958 (Fed. Cir. 2005). In an 8-1 decision, the Supreme Court reversed. Justice Scalia, writing for the majority, held that the jurisdictional requirement for a “case or controversy” requires that a dispute be “definite and concrete,” as opposed to merely seeking “an opinion advising what the law would be upon a hypothetical state

¹⁰ *Seagate* did not distinguish, however, whether opinion counsel and trial counsel could be at the same firm.

of facts.” 127 S. Ct. at 771 (internal quotation marks and citation omitted). “‘Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.’” *Id.* (quoting *Md. Cas. Co. v. Pac. Coal & Oil Co.*, 312 U.S. 270, 273 (1941)).

He then considered whether a “definite and concrete” controversy required that a declaratory judgment plaintiff expose itself to legal action before bringing a declaratory judgment action. Justice Scalia noted that a plaintiff threatened with action of the government does not have to expose itself to liability to create jurisdiction. In the patent context, the Court relied on *Altvater v. Freeman*, 319 U.S. 359 (1943). In *Altvater*, the defendant licensee filed, as a counterclaim, a request for a declaratory judgment that the patents-in-suit were invalid, “in the meantime paying ‘under protest’ royalties required by an injunction the patentees had obtained in an earlier case.” *MedImmune*, 127 S. Ct. at 773. The Court rejected the Federal Circuit’s distinguishing of *Altvater* on the basis that the licensee was, in that case, paying royalties under the threat of an injunction as opposed to a license agreement. The Supreme Court held that the Constitution does not require a licensee to “bet the farm, or (as here) risk treble damages and the loss of 80 percent of its business, before seeking a declaration of its actively contested legal rights.” *Id.* at 775.

The majority noted, however, that the license agreement between MedImmune and Genentech did not include a provision *prohibiting* a patent challenge and the Court could not find an implied promise:

To begin with, it is not clear where the prohibition against challenging the validity of the patents is to be found. It can hardly be implied from the mere promise to pay royalties on patents “which have neither expired nor been held invalid by a court or other body of competent jurisdiction” Promising to pay royalties on patents that have not been held invalid does not amount to a promise *not to seek* a holding of their invalidity.

Id. at 776.

Justice Thomas dissented, asserting that patent invalidity is “an affirmative defense to patent infringement, not a freestanding cause of action.” *Id.* at 780. “Because neither Genentech nor MedImmune had a cause of action, MedImmune’s prayer for declaratory relief can be reasonably understood only as seeking an advisory opinion about an affirmative defense it might use in some future litigation.” *Id.* In particular, Justice Thomas asserted that MedImmune wanted to know “whether, if it decides to breach its license agreement with Genentech, and if Genentech sues it for patent infringement, it will have a successful affirmative defense.” *Id.*

B. The Extension of *MedImmune* to Prospective Licensees

The reasoning of *MedImmune* has been extended to *prospective* licensees. In *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372 (Fed. Cir. 2007) *reh'g denied* June 8, 2007), the Federal Circuit reversed the dismissal of a declaratory judgment action based on licensing discussions. In particular, the defendant provided the plaintiff with several infringement analyses but also indicated that it had no intention of suing the plaintiff. The district court, relying on the Federal Circuit's "reasonable apprehension" of suit test, dismissed the action. The Federal Circuit reversed in light of the *MedImmune* decision. In particular, the Federal Circuit applied the *MedImmune* logic to licensing negotiations:

In the context of conduct prior to the existence of a license, declaratory judgment jurisdiction generally will not arise merely on the basis that a party learns of the existence of a patent owned by another or even perceives such a patent to pose a risk of infringement, without some affirmative act by the patentee. But Article III jurisdiction may be met where the patentee takes a position that puts the declaratory judgment plaintiff in the position of either pursuing arguably illegal behavior or abandoning that which he claims a right to do. We need not define the outer boundaries of declaratory judgment jurisdiction We hold only that where a patentee asserts rights under a patent based on certain identified ongoing or planned activity of another party, and where that party contends that it has the right to engage in the accused activity without license, an Article III case or controversy will arise and the party need not risk a suit for infringement by engaging in the identified activity before seeking a declaration of its legal rights.

Id. at 1380-81.

The Federal Circuit held that SanDisk had established a sufficient case and controversy, based on the specific infringement analyses provided by the defendant. The court held that SanDisk "need not 'bet the farm,' so to speak, and risk a suit for infringement by cutting off licensing discussions and continuing in the identified activity before seeking a declaration of its legal rights." *Id.* at 1382 (footnote omitted).

The defendant's statement that it had "absolutely no plan whatsoever to sue" was insufficient to moot the controversy. *Id.* at 1382. In a footnote, however, the court noted that to "avoid the risk of a declaratory judgment action, ST could have sought SanDisk's agreement to the terms of a suitable confidentiality agreement." *Id.* at 1375 n.1. The court distinguished such a confidentiality agreement from an agreement under Fed. R. Evid. 408. *Id.* In light of *SanDisk*, patentees are less likely to engage in licensing discussions prior to filing suit. At the least, a patentee will first require that any discussions be pursuant to a confidentiality agreement.

C. The Licensing Ramifications

The *MedImmune* decision creates significant risks for licensors. First, the mere offering of a license to a prospective licensee may create jurisdiction for declaratory judgment action. In those circumstances, the licensor may be sued in an inconvenient or otherwise unfavorable forum.

There are at least two ways this might be avoided. First, the licensor could sue first and talk later. Under this approach, the licensee would file the lawsuit, and then initiate licensing discussions. Second, the licensor may want, prior to any licensing discussions, to enter into a pre-negotiation “confidentiality agreement,” as suggested in *SanDisk*. The prospective licensee may refuse, of course, to enter into any such agreement without knowing, in advance, the nature of the discussions.

In addition to issues concerning prospective licensees, *MedImmune* also allows a licensee to agree to an ongoing (e.g., sales-based) license, and then seek legal action to invalidate or limit the scope of the license. Under the facts of *MedImmune*, the patentee would be unable to terminate the agreement. How can the licensor avoid this outcome?

There have been at least five suggested approaches.¹¹ They are (1) prohibiting a challenge or providing for termination of the agreement in case of a challenge; (2) adjusting the royalty in response to any unsuccessful challenges; (3) incorporating the license terms into a consent judgment; (4) requiring a paid-up license of some form (e.g., in association with a promissory note); and (5) providing for arbitration of any disputes concerning the scope of the license obligation. Each of these is discussed briefly below.

1. Prohibition of Challenge

In *MedImmune*, the contract had no clause prohibiting a challenge to the validity of the patent. The most straightforward response would thus be including such a clause, or expressly providing that the licensor could terminate the license in response to a challenge. This may dissuade the licensee’s challenge of the patent, particularly if the license covers multiple patents or rights. In particular, licensees are unlikely to challenge one of such patents, if the entire license would be at risk.

2. The Varying Rate

The licensing agreement can also incorporate other disincentives to challenges, such as a lower royalty rate in exchange for an agreement not to challenge and/or a higher royalty in response to any unsuccessful challenge. The higher royalty could be justified based on the additional value associated with the patent following an unsuccessful challenge.

¹¹ Larry Pope, of Mayer Brown, summarized these approaches in his presentation at a seminar at the University of Washington on July 20, 2007, in association with the Center for Advanced Study and Research of Intellectual Property.

3. The Consent Judgment Approach

A consent judgment could be entered into as part of a license agreement. In particular, a consent judgment could include an injunction prohibiting the defendant from infringing the patent and/or engaging in certain behavior (e.g., selling identified goods) without authority. As part of the consent judgment, the defendant would concede the validity and enforceability of the patent. The consent judgment likely has *res judicata* effect, precluding a challenge to the patent. See *Foster v. Hallco Mfg. Co.*, 947 F.2d 469 (Fed. Cir. 1991) (consent judgment of validity precluded subsequent challenge to validity).

The downside of this approach is that it requires a lawsuit to be filed prior to entering into a settlement agreement.¹²

4. The Paid-Up License

Another solution is a paid-up license. License payments made before a challenge to a patent are nonrefundable. See *Abbott Labs. v. Diamedix Corp.*, No. 96C5201, 1998 WL 901671, at *7 (N.D. Ill. Dec. 18, 1998) (“a licensee may challenge the validity of a patent under which he is licensed . . . and an adjudication of invalidity will permit rescission of the license agreement, but will not permit the licensee to recover royalties paid prior to bringing suit”) (citation omitted); see also *Studiengesellschaft Kohle, m.b.H. v. Shell Oil Co.*, 112 F.3d 1561 (Fed. Cir. 1997) (holding that patentee entitled to recover royalties up to the date licensee challenges validity). Accordingly, a licensee has no incentive to challenge a patent if it would not result in any savings to it. Another advantage of a paid-up license is that it avoids the need to report sales and to provide the licensor a right to audit the books and records of the licensee.

The arrangement does, however, shift a risk of a patent invalidity judgment to the licensee (i.e., a licensee making ongoing payments could cease such payments if the patent was declared invalid). Accordingly, this shifting risk, as well as a time discount, will result in a discount through the licensee.

In addition, a licensee may have difficulty paying the full royalty in one payment. These concerns could be negotiated by the licensee providing a promissory note, requiring payment for a pre-existing debt. The note would presumably be enforceable, even if the patent were declared invalid.

5. Arbitration

Another possible approach is requiring that any disputes concerning obligations under the agreement, whether they are relating to validity or infringement, are subject to arbitration. Courts liberally enforce arbitration agreements. See *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983), *superseded by statute*, *Bradford-Scott Data Corp., Inc. v. Physician Computer Network, Inc.*, 128 F.3d 504 (7th Cir. 1997)

¹² If the parties resolve the issue in advance of filing a lawsuit, there would presumably be no controversy sufficient to support subject matter jurisdiction for the lawsuit.

(referring to “liberal federal policy favoring arbitration agreements”); *see also* 35 U.S.C. § 294 (expressly allowing arbitration-related contract disputes). Further, the licensing agreement can specify the nature of the arbitration. The agreement can limit discovery, for example, and possibly even limit the nature of the defenses to be arbitrated. The agreement could include an admission of infringement for certain specified products.

The arbitration approach can avoid litigation, and avoid possible collateral estoppel effect that would arise from litigation.

The above approaches could also be combined. As an example, a licensing agreement could provide for arbitration of disputes, and, should the licensee lose, any royalty amount would increase.