



ANOTHER CHANGE IN U.S. PATENT LAW: U.S. SUPREME COURT RULES THAT PATENT LICENSEES MAY SEEK DECLARATORY JUDGMENTS IN PATENT-LICENSE CASES WITHOUT FIRST BREACHING THE LICENSE

Overturing Federal Circuit precedent to the contrary, the U.S. Supreme Court on January 9, 2007, held by an 8-1 vote that a patent licensee may seek a declaratory judgment that it has no duty to pay royalties under its license agreement, and may do so without first terminating or breaching that agreement. This is a significant change to existing law, it leaves several questions open to be resolved in future cases, and it raises important issues for the negotiation and drafting of patent-license agreements.

In *MedImmune, Inc. v. Genentech, Inc.*, No. 05-608, the Court held that even when a patent licensee has neither terminated nor breached its license agreement, and thus is in no “imminent” danger of being sued by the licensor for patent infringement, the licensee’s

challenge of its obligation to pay royalties (on the grounds that the patent is invalid or unenforceable or simply has not been infringed by the licensee) presents a justiciable case or controversy within the meaning of Article III of the Constitution, and thus an “actual controversy” over which U.S. federal courts may assert jurisdiction under the Declaratory Judgment Act. Previously, the Court of Appeals for the Federal Circuit had ruled that unless a patent licensee had materially breached the license, the licensee could not have any “reasonable apprehension” that the licensor would sue the licensee for infringement; thus, the licensee’s challenge to its obligation to pay royalties under the agreement was not an “actual controversy” that the federal courts could adjudicate.

The Facts of the *MedImmune* Case

The Supreme Court's opinion set forth these facts: MedImmune manufactures a drug called Synagis®. In 1997, MedImmune entered into a patent-license agreement with Genentech. The license covered an existing Genentech patent relating to the production of antibodies, and a second, then-pending Genentech patent application, relating to the "coexpression of immunoglobulin chains in recombinant host cells." Subsequently, the "coexpression" application matured into a patent. Under the license, MedImmune was required to pay a royalty on sales of "Licensed Products," which the license agreement defined as those products "the manufacture, use or sale of which ... would, if not licensed under th[e] Agreement, infringe one or more claims of either or both of [the covered patents,] which have neither expired nor been held invalid."

Shortly after the "coexpression" patent issued, Genentech informed MedImmune that in its view, Synagis® was covered by that patent and that MedImmune should begin paying royalties on Synagis® under the license agreement. MedImmune contended that the "coexpression" patent was invalid and unenforceable and, even if valid, was not infringed by Synagis®.

If MedImmune had refused to pay the demanded royalties, had then been sued by Genentech for patent infringement, and had lost, MedImmune could have been liable for treble damages and attorney's fees and could have been enjoined from selling Synagis®, a product that accounted for more than 80 percent of its revenues. Unwilling to take that chance, MedImmune instead paid the demanded royalties "under protest and with reservation of all its rights" and then filed a declaratory-judgment action seeking a declaration that the "coexpression" patent was invalid, unenforceable, or not infringed by Synagis®. Both the trial court and the Federal Circuit had dismissed the action, applying the existing Federal Circuit precedent noted above.

The Supreme Court's Ruling

The Supreme Court reversed those lower-court rulings and remanded the case for further proceedings. Its decision acknowledged that as long as MedImmune continued to make the demanded royalty payments, the prospect that Genentech would sue MedImmune for infringement was "at least remote, if not nonexistent." Even so, the Court held that MedImmune's suit presented a case or controversy

within the meaning of Article III and thus met the Declaratory Judgment Act's "actual controversy" language. The Court reasoned: "The rule that a plaintiff must destroy a large building, 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 finds no support in Article III." Citing a 1943 Supreme Court decision involving similar facts, the Court held that "the requirements of [a] case or controversy are met where payment of a claim is demanded as of right and where payment is made, but where the involuntary or coercive nature of the exaction preserves the right to recover the sums paid or to challenge the legality of the claim."

Genentech had argued that a patent license was akin to an insurance policy giving MedImmune immunity from an infringement action for so long as it both continued to pay royalties and did not challenge the validity of the licensed patent. According to Genentech, allowing MedImmune to keep the benefit of that immunity while simultaneously seeking to avoid its royalty obligation deprived Genentech of the benefit of its contractual *quid pro quo*. The Court rejected that argument, finding that the license merely required MedImmune to pay royalties to the extent that its products infringed on valid patents held by Genentech: "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." Nor, the Court said, did it amount to a promise not to contest the question of infringement.

The Court also dismissed Genentech's reliance on "the common-law rule that a party to a contract cannot at one and the same time challenge its validity and continue to reap its benefits." The Court held that MedImmune was not "repudiating or impugning" the license agreement but merely "asserting that the contract, properly interpreted, does not prevent it from challenging the patents, and does not require the payment of royalties because the patents do not cover its products and are invalid." In any event, the Court said, Genentech's arguments about the meaning of the licensing agreement and about the common-law rule against simultaneously challenging and benefiting from a contract were arguments going to *the merits*, and not to the question of whether Article III of the U.S. Constitution conferred subject-matter jurisdiction over MedImmune's declaratory-judgment action in the first place.

Having concluded that the case fell within Article III, the Court then turned to an alternative argument made by Genentech—that the rejection of MedImmune’s suit by the district court was a proper exercise of its discretionary power to decline jurisdiction under the Declaratory Judgment Act, which says only that a court “may” (not “must”) “declare the rights and other legal relations of any interested party.” The Court declined to address that question, because it had not been addressed by the lower courts and because it was a question vested “in the first instance” in the district court, which is in a better position to assess the “equitable, prudential and policy arguments” that inform the exercise of discretion. The Court thus remanded the case to the district court for initial consideration of both that issue and any “merits-based arguments for denial of declaratory relief.”

What *MedImmune* Means and What Questions It Raises

The Supreme Court’s *MedImmune* decision is likely to make it easier for patent licensees to get into federal court to contest their obligation to pay royalties—either by challenging the validity of the relevant patents or (at least in cases where a royalty obligation depends on a licensed product actually infringing a patent) by asserting that the licensee’s products do not infringe. At least as an initial matter, it appears that licensees can now obtain federal-court jurisdiction over such challenges without first terminating or breaching their license agreements and risking the very serious consequences that might follow.

At the same time, it is important to recognize that the Supreme Court’s decision only addresses the question of federal-court jurisdiction and does not address the merits of an underlying challenge to a license agreement. As a result, the Court’s decision leaves some interesting questions to be answered in future cases.

The Court expressly left open the question of whether a licensee that does not terminate the patent license before suing will remain liable for royalty payments while the challenge is pending. Under a typical patent license, the licensee’s royalty obligation continues until the covered patent *has been declared invalid*. So, if the license were signed in 2000 and the patent not declared invalid until 2010, the plain language of the agreement would suggest that 10 years of royalty payments are due for those years. But in *Lear, Inc. v. Adkins* (1969), the Court held that licensees who discontinue

royalty payments based on the claim that the patent is invalid before bringing suit owe no royalties, due to “overriding federal policies [that] would be significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging patent validity in the courts.” Now that nonrepudiating licensees are similarly able to challenge patent validity, the question remains whether those same “overriding federal policies” would require a refund of the amounts that the licensee paid under protest or into escrow if the licensee is ultimately successful in its challenge.

The Court also left open the question of whether a patentee can treat the licensee’s filing of a declaratory-judgment action as an anticipatory breach, thereby allowing the patentee to bring its own patent-infringement claim. This is important because a patentee may be able to recover far more on a patent claim (which can include trebled damages) than under a contractual-license claim. Thus, future cases will need to consider whether, and to what extent, patentees facing *MedImmune*-type challenges may declare a breach of the license and bring a patent-infringement counterclaim.

Further, the Court was careful to say that the traditional discretionary authority to decline to hear a declaratory-judgment action remains in force. Indeed, the Court at least suggested the possibility that there may be occasions where “equitable, prudential and policy arguments” would *require* the court to dismiss such an action. Future cases will have to develop the facts and circumstances where such a discretionary dismissal is either appropriate or mandated.

Finally, the Court did not address the question whether a licensee could contract away its *MedImmune* rights. Here, the Court noted that the *MedImmune*/Genentech license could not be interpreted as creating an implied promise not to challenge validity, but it did not address what might happen if a license contained an *express* promise on the licensee’s part not to challenge the validity of that patent unless and until the licensee terminated or breached the license. In the Court’s 1969 *Lear v. Adkins* decision, the Court took a dim view of the prospect that a license could prevent a licensee from challenging the validity of a patent *at all*, finding any such promise to be unenforceable on public-policy grounds. Still, it may be a separate question whether *Lear* would similarly invalidate a licensor’s attempt to prevent a licensee *who has not yet terminated or breached the license* from

challenging patent validity. Certainly, the Federal Circuit has suggested that *Lear* is not unlimited in scope—for example, that court has held that *Lear* does not prevent the enforceability of a promise not to challenge validity where that promise is made in connection with settling pending litigation involving the patent. If such provisions are enforceable, then patent owners (prospective licensors) may consider including such provisions in their licensing agreements, thereby ensuring that licensees will not be able to take advantage of their immunity from an infringement suit while simultaneously pursuing invalidity challenges.

In sum, the *MedImmune* case represents another example of the U.S. Supreme Court's apparently increased interest in patent cases, and as with the Court's decision last term in *eBay v. MercExchange*, dealing with injunctive relief in patent-infringement cases, it sets aside a line of established Federal Circuit case law. The Court still has on its docket *KSR International Co. v. Teleflex, Inc.*, another case challenging an established line of accepted Federal Circuit precedent (involving the nonobviousness standard of Section 103 of the Patent Act); a decision in that case should come before the end of June 2007.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Gregory A. Castanias

1.202.879.3639

gcastanias@jonesday.com

Douglas R. Cole

1.614.281.3659

drcole@jonesday.com

Stephen J. Goodman

1.202.879.7609

sjgoodman@jonesday.com

Jones Day publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information purposes only and may not be quoted or referred to in any other publication or proceeding without the prior written consent of the Firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our "Contact Us" form, which can be found on our web site at www.jonesday.com. The mailing of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship. The views set forth herein are the personal views of the authors and do not necessarily reflect those of the Firm.