



Electronic Dispatch

Intellectual Property Law Information Memo

January 2007

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NEW ARROW FOR LICENSEES' QUIVERS – SUPREME COURT CHANGES BALANCE OF POWER WITH LICENSORS

Prior to the recent Supreme Court case, *MedImmune, Inc. v. Genentech, Inc.*, 2007 U.S. Lexis 1003 (Jan. 9, 2007), a patent licensee faced a tough choice when it believed that the patent covered by the license was invalid or not infringed:

- Should the licensee continue to make royalty payments on an invalid and/or unenforceable patent regarding a technology that the licensee should arguably be free to practice, or
- Should the licensee risk being enjoined from practicing the licensed technology and face actual and potentially trebled damages by stopping royalty payments (materially breaching the license agreement), in order to bring a declaratory judgment action to challenge the validity and/or scope of the patent under which it was licensed.

Federal Circuit Precedent – Cease Payment of Royalties Requirement

Until the Supreme Court's *MedImmune* decision, Federal Circuit precedent required a patent licensee to materially breach its license by discontinuing royalty payments in order to have standing to bring a declaratory judgment action to challenge a licensed patent. See *Gen-Probe, Inc. v. Vysis, Inc.*, 359 F.3d 1376, 1381 (Fed. Cir. 2004). Without such a "material breach" of the license agreement by the licensee, the Federal Circuit held that the licensee does not have a "reasonable apprehension" that it will be sued for patent infringement. *Id.* at 1382. In other words, due to the licensee's continued payment of royalties under the agreement, the licensor does not have grounds to sue the licensee for infringement and to enjoin the licensee's actions (e.g., making, selling) with respect to the licensed technology. Therefore, under this scenario, the Federal Circuit held that the "actual controversy" requirement, which supports jurisdiction under the Declaratory Judgment Act (28 U.S.C. § 2201(a)), does not exist. *Id.*

Federal Circuit – *MedImmune, Inc. v. Genentech, Inc.*

Pursuant to this precedent, the Federal Circuit in *MedImmune, Inc. v. Genentech, Inc.*, 427 F.3d 958 (Fed. Cir. 2005) affirmed the district court's dismissal of the case as "non-justiciable under the Declaratory Judgment Act." *MedImmune, Inc.*, 427 F.3d at 962, 965.

MedImmune involved a patent license agreement between Genentech and MedImmune, which covered an existing Genentech patent and a then-pending patent application. Under the license agreement, MedImmune agreed to pay royalties to Genentech for the right to make, use and sell its Synagis drug (which is used to prevent respiratory tract disease in children). When the pending patent application issued as a patent, Genentech sent a letter to MedImmune stating that Genentech expected MedImmune to start making royalty payments with respect to this newly issued patent, due to Genentech's belief that the patent covered Synagis.

MedImmune disagreed with Genentech and believed that the newly issued patent was invalid and unenforceable. Further, even if the patent were found to be valid and enforceable, MedImmune believed that the patent did not cover Synagis. MedImmune, however, understood Genentech's letter as a threat that Genentech would sue MedImmune for patent infringement and seek to enjoin its sales of Synagis if it failed to make royalty payments as demanded. Rather than risk losing a patent infringement suit, having to pay actual and perhaps treble damages, and being enjoined from selling Synagis (which accounted for more than 80% of its revenue from sales since 1999), MedImmune continued making royalty payments to Genentech "in protest" and filed a declaratory judgment action challenging the validity and enforceability of the newly issued patent.



Since MedImmune (as the licensee in *Gen-Probe*) continued to pay royalties to Genentech, the Federal Circuit held that MedImmune was “under no threat or apprehension of suit” and therefore did not have standing to bring suit under the Declaratory Judgment Act challenging the validity of the licensed patent. *Id.* at 963-64, 965.

Supreme Court – *MedImmune, Inc. v. Genentech, Inc.*

The Coercion Principle: A Licensee is not Required to Materially Breach a Patent License Agreement by Stopping Payment of Royalties Before Seeking a Declaratory Judgment Challenging a Licensed Patent Where the Payment of Royalties was Effectively Coerced

The Supreme Court reversed the Federal Circuit’s affirmance of the district court’s dismissal of MedImmune’s declaratory judgment action for lack of subject matter jurisdiction. The Supreme Court held that MedImmune was not required to breach the license agreement by stopping royalty payments before seeking a declaratory judgment that the challenged patent was invalid, unenforceable, or not infringed.

The Supreme Court reasoned that even though MedImmune’s continued payment of royalties eliminated the “immediate threat” of suit by Genentech, MedImmune’s “threat-eliminating behavior was effectively coerced” by the “threat of treble damages and loss of 80 percent” of MedImmune’s business. *See MedImmune, Inc.*, 2007 U.S. Lexis 1003 at *21, 28 n.12 (emphasis added). Thus, the Supreme Court noted that its “coercion principle” conflicts with the Federal Circuit’s “reasonable apprehension of suit test,” i.e., the elimination of the apprehension of suit does not negate the ability of the licensee to file a declaratory judgment action where a licensee “pays royalties for fear of treble damages and an injunction fatal to his business.” *Id.* at 26 n.11.

Advice for the Patent Licensor: Prohibiting the Licensee From Challenging the Validity of the Patent Through Explicit Contractual Language

Despite the tone of the opinion, the Supreme Court’s *MedImmune* decision does not represent a complete windfall for patent licensees. The decision leaves some wiggle room for the patent licensor to protect itself from patent validity challenges.

In response to an argument by Genentech, the Supreme Court noted that MedImmune asserted that “the contract, properly interpreted, does not prevent it from challenging the patents . . .” *Id.* at *30-31 (emphasis added). The Supreme Court also noted that it could not find “a prohibition against challenging the validity of the patents” in the agreement. *Id.* at *29. Further, the Court stated that this prohibition could not be “implied from the mere promise to pay royalties on patents” that have not been held invalid. *Id.*

This discussion by the Supreme Court suggests that a patent licensor might protect itself from a declaratory judgment action by a licensee seeking a declaration of invalidity, through the use of explicit language in the patent license agreement which states that the licensee is prohibited from challenging the validity of the licensed patent(s).

This precedent is certain to spark a rise in suits being filed by licensees who believe they are being coerced into paying royalties against their licensors, and other factual circumstances will be analyzed to continue the evolution of this area of licensing law. In addition, it is probable that some licenses will be renegotiated to the benefit of the licensees who now have this added arrow in their quivers to use in the negotiation process.

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