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Review of Developments in Intellectual Property Law

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License Agreements in the Wake of *Quanta*: A Potential Need for Restructuring

On June 9, 2008, the Supreme Court decided *Quanta Computer, Inc. v. LG Electronics, Inc.*[1] At issue was whether the doctrine of patent exhaustion applied to the sale of components of a patented system, where such components must be combined with additional components in order to practice patented methods.[2] The Court held (1) that the patent exhaustion doctrine does indeed apply to method patents[3] and (2) that an authorized sale of an article that "substantially embodies" the patent exhausts a patent owner's rights under patent law.[4] The Court attempted to temper this holding by observing in a footnote that contract damages may be available to a patentee even where patent exhaustion operates to eliminate patent damages.[5] This concession comports with Federal Circuit law holding that "private parties retain the freedom to contract concerning conditions of sale," when that sale is conditioned upon a lawful restriction.[6]

In the wake of *Quanta*, patent holders should consider carefully constructing the conditions of sale so as to limit licensees' rights, as opposed to attempting to limit downstream third parties' rights that flow from the licensee. Likewise, licensees should negotiate royalty payments that account for the lower value of these restricted patent rights. In general, then, patent holders and licensees should consider reevaluating what is and is not "authorized" under their license agreement(s).

The *Quanta* Decision

Quanta settled a dispute between a group of

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KSR – One Year Later

The Supreme Court decided *KSR International Co. v. Teleflex, Inc.*[1] a little more than a year ago. Since then, the patenting community has watched to see how the lower courts would interpret the decision. After all, *KSR* involved a relatively simple invention: electronic pedal sensors for computer-controlled throttles. What would *KSR* mean for the patentability of complex inventions in fields such as biotechnology, medicinal chemistry, digital communications, and nanotechnology?

KSR and the TSM Test

The Federal Circuit has long employed a teaching, suggestion, or motivation test (the so-called "TSM test"), under which a patent claim is only proved obvious if the prior art, the nature of the problem solved, or the knowledge of a person having ordinary skill in the art reveals some motivation or suggestion to combine the prior art teachings in a manner that renders the claim obvious. The TSM test played the central role in *KSR*'s legal drama.

Prior to reaching the Supreme Court, the Federal Circuit had reversed the district court's finding that the patented invention was invalid as obvious.[2] The defendant's obviousness argument had relied on combining the teachings of two separate references.[3] The district court found that the combination was proper because it was suggested by the nature of the problem to be solved.[4] Relying on the TSM test, the Federal Circuit ruled that the combination was improper because neither reference precisely addressed the problem that the invention allegedly solved.[5]

The Supreme Court reversed the Federal Circuit,

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computer manufacturers (Quanta) and a patent owner, LG Electronics (LGE), that arose when the patent licensee, Intel Corporation (Intel) sold components—that "substantially embodied" LGE's patent claims—to Quanta. More specifically, LGE granted Intel the right to manufacture and sell microprocessors and chipsets that practiced the LGE patents. Quanta purchased these products from Intel and then used them, in combination with non-Intel parts, to manufacture computers. LGE alleged that Quanta's computers infringed LGE's patents, and consequently, wanted Quanta to pay a licensing fee. Quanta refused.

In *Quanta*, there were two separate agreements between LGE and Intel: a License Agreement and a Master Agreement. The License Agreement granted Intel a broad set of patent rights, which ensured that any Intel product purchased by a third party would be licensed by LGE. However, the License Agreement attempted to qualify the third-party licenses with a provision stating that the license did not extend to third-party products made by combining Intel products with any non-Intel product.[7] The Master Agreement required Intel to give written notice of this same provision to its customers. In addition, the Master Agreement stated that a breach of the agreement would have no effect on and would not be grounds for termination of the License Agreement.

The Court held that the License Agreement granted full rights to the manufacturer Intel to "make, use, [or] sell" patented microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts.[8] In the Court's view, the only limitation imposed on the manufacturer was contained in the separate Master Agreement, which required that Intel give notice to its customers that they were not licensed by LGE to combine Intel parts with non-Intel parts.[9] The Court noted that neither party asserted that Intel breached either agreement.[10] Therefore, the Court held that Intel's authority to sell the licensed products was not conditioned on giving notice to a third party (Quanta), or on the third party's (Quanta's) decision to abide by that notice.[11]

However, in view of these facts, the Court's suggestion in a footnote[12] that contract damages may be available even where exhaustion eliminates patent damages seems inconsistent, because any sales stemming from a breach of contract should render those sales unauthorized. Since an unauthorized sale is not captured by the patent exhaustion doctrine, patent damages should logically still be available. Thus, it is unclear how contract damages can mitigate a patent holder's losses when a patent is exhausted due to an authorized sale.

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The Court's express distinction between a conditional and an unconditional license means *Quanta* may only apply to *unconditional* authorized sales.

Federal Circuit & Supreme Court Precedent in Favor of Conditional Sales Still Stands

Importantly, the Court explicitly distinguished *Quanta* from an earlier Supreme Court decision, *General Talking Pictures Corp. v. Western Electric Co.*[13], which held that a manufacturer that sold patented amplifiers for commercial use breached a license that limited the manufacturer to selling the amplifiers for only private and home use. In *Talking Pictures*, the Court held that the manufacturer "could not convey to petitioner what both knew it was not authorized to sell."[14] The aforementioned limitation is called a field-of-use restriction. These types of limitations have been upheld by the Federal Circuit and are reviewed under the rule of reason for any anticompetitive effects.[15] The Court acknowledged that Quanta's license was unlike the license in *Talking Pictures*, because LGE gave full, unconditional rights to Intel to "make, use, [or] sell" the patented products. The Court's express distinction between a conditional and an unconditional license means that *Quanta* may only apply to *unconditional* authorized sales.

In a more recent case, *B. Braun Medical, Inc. v. Abbott Laboratories*, the Federal Circuit emphasized that an *unconditional* sale of a patented device exhausts the patentee's right to control the purchaser's use thereafter because "in such a transaction, the patentee has bargained for, and received, an amount equal to the full value of the goods."[16] The *B. Braun* court was quick to point out, however, that the exhaustion doctrine does not apply to a *conditional* sale or license, a transaction in which "it is more reasonable to infer that the parties negotiated a price that reflects only the value of the 'use' rights conferred by the patentee."[17]

However, it should be noted that conditions on sales are not without limits, but "[u]nless the condition violates some other law or policy (in the patent field, notably the misuse or antitrust law), private parties retain the freedom to contract concerning conditions of sale."[18] "The appropriate criterion is whether [the patentee's] restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason."[19] There appears to be nothing within *Quanta*, which dealt exclusively with

an unconditional sale, that suggests alteration of this Federal Circuit precedent or the Supreme Court's own precedent in *Talking Pictures*.

Viable Licensing Structures

Nevertheless, *Quanta* serves as a reminder that patent exhaustion is alive and well—acting as a check against a patentee's control over patented goods after its first sale of goods or its licensee's first sale of such goods. While this limits the patentee's ability to maximize profits from patented technology, exhaustion's "check" may be balanced by including a proper condition of sale in the license. The point of emphasis that flows from *Quanta* is that patent exhaustion only operates when the first sale is authorized. Thus, important considerations when drafting a licensing agreement include (1) the use of conditional limitations, (2) obtaining full patent value at the initial sale, and (3) the potential retention of title by the patentee in the goods as they pass through the supply chain.

Post-*Quanta*, patent owners should carefully consider crafting the grant of their patent rights in order to restrict licensed manufacturers or sellers to particular types of authorized sales. For instance, a license agreement with a component supplier (like Intel) could be written to restrict that supplier's right to sell products to only those buyers who are also licensed by the patent holder. This restriction would remove any "unauthorized" sale to a non-licensed buyer from the purview of the patent exhaustion doctrine, which only exhausts patent rights for "authorized" sales. At least one commentator has noted, however, that "[f]orcing patentees to load up initial sales with all the terms necessary to tailor rights to potential uses will tend to increase transaction costs of initial licenses and probably result in lumpier, less tailored contracting in general."[20]

All the same, there are working examples that show that this licensing structure can be sound and practical. For instance, a conditional sale permitting multi-tier royalties is outlined in Qualcomm Inc.'s *amicus* brief in *Quanta*, wherein Qualcomm describes its license as being "limited in scope and conditioned upon the licensee acting within the bounds of its limited license."[21] Qualcomm conditions the licensed patent rights to provide chipmakers with a right "to make (or have made)" the patented product and a restricted right "to sell" the product only to downstream buyers who are "authorized purchasers."[22] Authorized purchasers are defined in the license as buyers of chips for incorporation into fully-assembled handsets who themselves have a license from Qualcomm to make, use, and sell fully-assembled products that, in the absence of a license, would infringe Qualcomm's patents.[23] Unlike authorized purchasers, the chipmakers are not granted the right to use the chips, and may not pass along such a right to use chips to make, operate, or sell handsets or any other product.[24] If the chipmakers violate the agreement by selling to non-authorized purchasers, then the licensee has likely materially breached the license and Qualcomm may terminate the agreement, including the license granted.[25]

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Quanta serves as a reminder that patent exhaustion is alive and well.

Similarly, one commentator has identified how field-of-use restrictions (FOURs) may be leveraged to properly condition a license.[26] A FOUR may be used to restrict the definition of licensed products so they would not substantially embody an unlicensed method.[27] For example, if an unlicensed biotechnology method involves the use of a specific promoter, licensed products could be defined to exclude products incorporating that promoter.[28] Alternatively, a FOUR could restrict the authorized use to a specified field, such as permitting the sale of licensed products only for use in the licensed method (*i.e.* for use in diagnostics but not therapeutics).[29]

Another possibility is to restructure vertical licensing schemes altogether. For example, a license could be crafted to intentionally exhaust all patent rights in the initial sale. The patent holder could exclusively license to first-tier suppliers, transferring all patent rights to them, and collect the full royalty in an upfront payment, rather than licensing to multiple suppliers in the manufacturing chain.[30] Under this approach, the first-tier suppliers must be willing to bear the risk of financing such a large lump-sum payment, with no guarantee they will recoup this investment from lower-tier suppliers—a risk that would be reflected in the price of the royalty.

In emerging markets for new technology with an untested consumer base, a supplier would be less likely to bear the risk of paying for the full patent rights. In that situation, the royalty structure may be conditioned on actual sales to additional suppliers or end users. This larger lump-sum royalty is already often employed in the biotech industry, where the majority of a biotechnology product is often made by a single entity.[31] Therefore, the biotechnology industry may provide guidance on how to value initial royalty payments in industries, such as electronics, that previously elected a multi-tier royalty structure.

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Similarly, the point of initial sale is an important consideration. Rather than licensing the same patents to multiple parties in different tiers of the supply chain, patent holders could bypass the suppliers and grant the license exclusively to original equipment manufacturers (OEMs). Since patent exhaustion follows the transfer of title, patent holders could simply retain title in the components throughout the manufacturing chain until final assembly. Structuring business in this manner would require a larger capital investment by the patent holder, given that current suppliers would essentially become subcontractors of the patent holders. A patent holder would then recoup this manufacturing investment plus a profit with a substantial royalty from the OEM—a royalty necessarily equivalent to the total patent value obtained under pre-*Quanta* licensing schemes.

Conclusion

The Supreme Court's decision in *Quanta* pertained to an unconditional, authorized sale, and the holding is likely limited to these facts. As such, prudent licensors should consider explicitly conditioning patent rights granted to a licensee, and avoid general language that simply denies licenses to third parties. By setting out conditions that define authorized sales in future licenses, patent owners will more easily be able to avoid exhausting valuable patent rights under *Quanta*. Conversely, prudent licensees should carefully consider explicit conditions placed on acquired patent rights, and should strive for a payment structure that reflects the value of the rights actually conveyed.

Endnotes:

1. *Quanta Computer Inc. v. LG Electronics., Inc.*, 128 S. Ct. 2109 (2008).
2. *Id.* at 2113.
3. *Id.* at 2118.
4. *Id.* at 2122.
5. *Id.* at 2122 n.7.
6. *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 708 (Fed. Cir. 1992).
7. *Quanta*, 128 S. Ct. at 2114.
8. *Id.* at 2121.
9. *Id.* at 2121-22.
10. *Id.* at 2121.
11. *Id.* at 2122.
12. *Id.* at 2122 n.7.
13. 58 S. Ct. 849 (1938).
14. *Id.* at 853.
15. *B. Braun Med., Inc. v. Abbott Labs.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997).
16. *Id.*
17. *Id.*
18. *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 708 (Fed. Cir. 1992) (internal citations omitted).
19. *Id.*
20. David McGowan, *Reading Quanta Narrowly*, http://www.patentlyo.com/patent/2008/07/reading-quanta.html (July 27, 2008).
21. Brief for Qualcomm Inc. as *Amicus Curiae* Supporting Respondents at 8, *Quanta Computer Inc. v. LG Elecs., Inc.*, 128 S. Ct. 2109 (2008) (No. 06-937). While this licensing structure has not been upheld by a court, it seems a reasonable approach in view of the authors' interpretation of *Quanta*.
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.* at 8-9.
26. Courtenay C. Brinckerhoff, *Enforceability of Patent Licenses Under Fire*, 28 Genetic Engineering & Biotech. News 14, Aug. 1, 2008; *see also* Florian Shuett, *Field-of-Use Restrictions in Licensing Agreements*, abstract (MPRA Paper No. 8534), available at http://mpra.ub.uni-muenchen.de/8534/.
27. Brinckerhoff, *supra* note 26.
28. *Id.*
29. *Id.*
30. Erin Coe, *Post-Quanta, Companies Rethink Licensing Strategies*, Law360, Aug. 19, 2008.
31. *Id.*

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yet largely affirmed the utility of the TSM test; at the same time, the Court warned against application of the test in a manner that would result in "[r]igid preventative rules that deny recourse to common sense."[6] In reaching its conclusion, the Court provided several additional signposts that indicated its desire for a more flexible obviousness inquiry.

First, the combined references need not address the problem solved by the claimed invention.[7] Rather, any need or problem known in the field and addressed by the references can provide a reason to combine the teachings of the references.[8] These, however, are old maxims.

Second, the Court also considered the forces driving innovation as important in the obviousness analysis, stating, "[o]ften, it will be necessary for a court…to determine whether there was an apparent reason to combine the known elements in the fashion claimed by the patent at issue.[9] And, "it can be important to identify a reason that would have prompted a person of ordinary skill in the relevant field to combine the elements in the way the claimed new invention does."[10] This sounds a lot like the suggestion or motivation to make a claimed invention under the TSM test.

Third, the predictability of a combination is more central to the obviousness inquiry than the source of the suggestion to make the combination. The Court noted: "[w]hen a work is available in one field of endeavor, design incentives and other market forces can prompt variations of it, either in the same field or a different one. If a person of ordinary skill can implement a predictable variation, [the Patent Act] likely bars its patentability."[11] "A court must ask whether the improvement is more than the *predictable* use of prior art elements according to their established functions.[12] "Predictability" under *KSR* sounds a lot like reasonable expectation of success under the TSM test.

Fourth, if a combination is "obvious to try," then the claimed invention may indeed be obvious. The Court reasoned: "[w]hen there is a design need or market pressure to solve a problem and there are a finite number of identified, predictable solutions, a person of ordinary skill has good reason to pursue the known options within his or her technical grasp. If this leads to the anticipated success, it is likely the product not of innovation but of ordinary skill and common sense."[13] Similarly, the Court observed, "[i]n many fields it may be that there is little discussion of obvious techniques or combinations, and it may often be the case that market demand, rather than scientific literature, will drive design trends."[14] The Supreme Court showed that it is interested in preventing the awarding of patents for innovations that would occur in the ordinary course of events.

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It is unclear whether *KSR* has done much to change the law of obviousness.

KSR and the Federal Circuit

The Supreme Court granted *certiorari* in June 2006[15], and in the following months, the Federal Circuit began emphasizing a flexible nature of its TSM test. For example, in the 2006 case of *DyStar Textilfarben GmbH v. C.H. Patrick Co.*[16], the court emphasized that the TSM test "is actually quite flexible and not only permits, but requires, consideration of common knowledge and common sense."[17]

Furthermore, in *Pfizer, Inc. v. Apotex, Inc.*[18], the Federal Circuit abandoned its earlier requirement that the motivation to combine must be suggested by the combined references. In *Pfizer*, the Federal Circuit found the motivation to combine in a host of references that were themselves not part of the combination asserted against the patent.[19] Hence, in late 2006 and early 2007, the Federal Circuit appeared to preempt to some extent the Supreme Court's decision in *KSR* by anticipating many of the aspects of the Supreme Court's decision.

It is unclear, therefore, whether the Supreme Court's decision in *KSR* has done much to change the law of obviousness. Clearly, the Supreme Court has eliminated the TSM test as an absolute threshold for challenging a patent as obvious. This is especially true for rigid applications of the TSM test that required the combined references to suggest the desirability of their combination. The Supreme Court's decision in *KSR* has replaced such rigid applications of the TSM test with a perhaps softer focus on the reasons that may drive one of ordinary skill in the art to the claimed invention, as well as the predictability of successfully achieving it. But this is not substantially different from the TSM test.

In the following sections, we survey several cases in which the Federal Circuit has applied this new rubric, and discuss how the Supreme Court's decision in *KSR* may or may not have affected the result. We divide our discussion between chemistry/pharmaceutical cases and electrical/mechanical cases.

Chemistry/Pharmaceutical Cases

Takeda Chemical Industries, Ltd. v. Alphapharm Pty., Ltd.[20], was one of the Federal Circuit's first post-*KSR* obviousness cases.

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The invention claimed by the asserted patent related to novel chemical compounds useful in the treatment of diabetes.[21] In *Takeda*, the claim at issue was directed to the compound pioglitazone, wherein an ethyl group is attached to the 5'-position of a pyridyl ring (see Figure 1). The alleged infringer argued that the claim at issue was obvious over the prior art compound b, which included a pyridyl ring with a methyl group attached at the 6'-position (see Figure 2).

Pointing to *KSR*, Alphapharm argued that it was "obvious to try" to modify the known compound to arrive at the claimed novel compound.[22]

The Federal Circuit rejected Alphapharm's argument, reasoning that *KSR*'s "obvious to try" language does not open the door to any speculative modification of a known compound.[23] Rather, modification of a known compound would be "obvious to try" if one of skill in the art could expect the modification to yield a predictable solution (*i.e.*, if there were a reason to expect the predicted result).[24] In this instance, there was nothing remarkable about compound b. In fact, it showed poor results as an antidiabetic agent and therefore taught away from its use as such a drug.[25] Thus, there would be no reason for a skilled artisan to modify compound b nor predictably expect that modifying it would lead to a compound having effectiveness as a diabetic therapy.[26] Thus, the Federal Circuit rejected a speculative "obvious to try" standard, and insisted on the central role of predictability. The Court agreed with the district court that Alphapharm had failed to establish a *prima facie* case of obviousness.

In *Aventis Pharma Deutschland GmbH v. Lupin, Ltd.*[27], the Federal Circuit applied a similar "predictability test" to declare a patented compound obvious. The patent's claims were directed to a purified stereoisomer of a particular compound useful as a treatment for hypertension.[28] It was already known that a mixture of the compound's various stereoisomers possessed efficacy for the same use.[29]

The Federal Circuit acknowledged that a purified compound is not always rendered obvious by a mixture containing the compound.[30] But the court noted that "if it is known that some desirable property of a mixture derives in whole or in part from a particular one of its components, or if the prior art would provide a person of ordinary skill in the art with reason to believe that this is so, the purified compound is prima facie obvious over the mixture even without an explicit teaching that the ingredient should be concentrated or purified."[31]

In *Aventis*, the court looked to an analogous series of stereoisomers that Merck had previously discovered.[32] In the Merck mixture, Merck scientists determined that a particular stereoisomer was the source of the mixture's therapeutic activity.[33] By using Merck's findings, the court held that one of skill in the art had reason to seek a stereoisomer primarily responsible for the activity, and could predictably determine which stereoisomer in the Aventis mixture would be responsible for the mixture's drug activity.[34] The court also noted that Aventis failed to show unexpected results sufficient to rebut the *prima facie* case of obviousness. Thus, the court emphasized predictability, but went outside of the immediate prior art to find the reason why the skilled artisan would select a particular stereoisomer from the mixture.

Finally, in *Eisai Co. Ltd. v. Dr. Reddy's Laboratories, Ltd.*[35], the court again considered

Figure 1

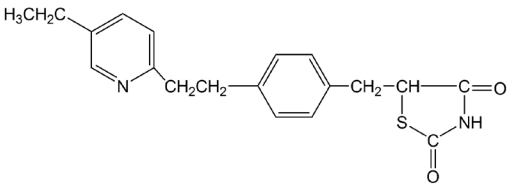
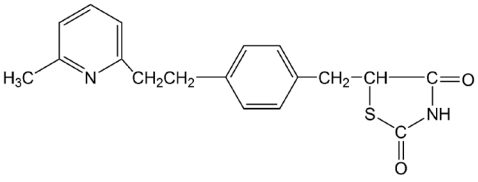


Figure 2



whether there was a reason to make the claimed compound at issue (rabeprazole) and predictability in achieving the observed results in view of a structurally similar prior art molecule (lansoprazole). Reddy's had argued that it would be obvious to modify lansoprazole to arrive at the structure for rabeprazole.[36] Reddy's, however, could point to no objective reason why such a modification would be desirable.[37] In responding to Reddy's speculative "obvious to try" argument, the Federal Circuit again emphasized that obviousness requires that any modifications of known compounds must achieve predictable results.[38] In fact, the Court suggested that this bar is relatively high for unpredictable chemical inventions: "[t]o the extent an art is unpredictable, as chemical arts often are, *KSR*'s focus on…'identified, predictable solutions' may present a difficult hurdle because potential solutions are less likely to be genuinely predictable."[39]

Electrical/Mechanical Cases

In recent cases involving consumer electronics, the Federal Circuit has embraced a post-*KSR* approach to obviousness that rejects rigid formulae in favor of more fact-oriented evaluations.[40] In *Leapfrog Enterprises, Inc. v. Fisher-Price, Inc.*[41], the Federal Circuit noted that the goal of the asserted claim was to allow a child to press a switch associated with a single letter in a word and hear the sound of the letter as it is used in that word.[42] The Court reasoned that "[a]ccommodating a prior art mechanical device that accomplishes that goal to modern electronics would have been reasonably obvious to one of ordinary skill in designing children's learning devices."[43] Thus, when an invention involves no more than updating prior-art devices using modern electronic components, the invention will likely be found obvious in view of commonly available and understood art.[44]

In the absence of more rigid approaches, it may now be easier to challenge the nonobviousness of an invention by combining references to show that the particular invention is the predictable result of combining familiar elements in accordance with well-known methods.[45] In *Agrizap Inc. v. Woodstream Corp.*[46], the court noted that, as conceded by Agrizap, the only difference between a prior-art device and the asserted claims was a type of switch used to complete a circuit that triggers a function.[47] The asserted claims simply substituted a resistive electrical switch for the mechanical pressure switch employed by the prior-art device.[48] The court stated that objective evidence of nonobviousness in this case, including any substantial evidence of commercial success, praise, and long-felt need, was inadequate to overcome such a strong *prima facie* case of obviousness (*i.e.*, favoring resistive switches over mechanical switches is not a novel point).[49]

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Reasons to make an invention, as well as predictability in successfully doing so, have become important elements in the obviousness analysis.

Application of *KSR* to Prosecution of Patent Applications

With the new flexibility for applying the TSM test, and the acknowledgement of several new valid obviousness positions, patent examiners at the U.S. Patent and Trademark Office may begin applying 35 U.S.C. § 103 more broadly in the future. However, regardless of the permissible level of flexibility in an obviousness inquiry, the burden of establishing a *prima facie* case of obviousness during prosecution still remains squarely with the examiner. According to MPEP §§ 2142 and 2143, an examiner seeking to establish a *prima facie* case of obviousness must clearly articulate reasons with rational, factual underpinnings to support the conclusion of obviousness. Consequently, an obviousness rejection from an examiner is subject to attack on at least two bases.

First, an obviousness rejection may be overcome if the examiner did not clearly articulate reasons why the claimed invention logically follows from the teachings of the cited art. Under MPEP § 2142, conclusory or irrational statements are insufficient to establish a *prima facie* case of obviousness. It also appears that *prima facie* obviousness is not established when an examiner merely identifies claim elements scattered among several references. Rather, the examiner must logically establish at least one reason why a person of ordinary skill in the art would be lead to modify the cited art to achieve the claimed invention.[50]

Second, an obviousness rejection may be overcome by establishing that the factual underpinnings relied on by the examiner are flawed or insufficient. Clearly, an obviousness rejection cannot be supported by an examiner's erroneous interpretation of a reference. A case of *prima facie* obviousness is also not established by a summary of the teachings of a collection of references. Rather, the examiner must support a conclusion of obviousness by showing how the references teach or lead to the claim elements.[51]

Conclusion

In the year since the Supreme Court issued its decision in *KSR*, the lower courts have

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applied the opinion in several cases involving a range of technologies. Of course, the long-term legacy of *KSR* is still unknown, and the jurisprudence surrounding obviousness will continue to evolve as courts wrestle with *KSR* and its progeny. It seems clear, however, that reasons to make a claimed invention, as well as predictability in successfully doing so, have become important elements in the obviousness analysis. In that regard, *KSR* (and the manner in which the Federal Circuit applies it) may not have a significant impact on the obviousness analysis of complex technology.

Endnotes:

1. 550 U.S. ____, 127 S.Ct. 1727 (2007).
2. *Teleflex, Inc. v. KSR Int'l Co.*, 119 Fed.Appx. 282, 285 (Fed. Cir. 2005).
3. *Id.* at 286-287.
4. *Id.*
5. *Id.* at 288.
6. *KSR Int'l Co.*, 127 S. Ct. at 1732.
7. *Id.* at 1741.
8. *Id.*
9. *Id.* at 1740-41.
10. *Id.* at 1741.
11. *Id.* at 1740.
12. *Id.* (emphasis added).
13. *Id.* at 1742.
14. *Id.* at 1732.
15. *KSR Int'l Co. v. Teleflex, Inc.*, 548 U.S. 902 (U.S. 2006).
16. 464 F.3d 1356 (Fed. Cir. 2006).
17. *Id.* at 1367.
18. 480 F.3d 1348 (Fed. Cir. 2007).
19. *Id.* at 1362.
20. 492 F.3d 1350 (Fed. Cir. 2007).
21. *Id.* at 1353.
22. *Id.* at 1359.
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. 499 F.3d 1293 (Fed. Cir. 2007).
28. *Id.* at 1295.
29. *Id.* at 1301.
30. *Id.*
31. *Id.*
32. *Id.* at 1302.
33. *Id.*
34. *Id.* at 1302-03.
35. 533 F.3d 1353 (Fed. Cir. 2008).
36. *Id.* at 1357-58.
37. *Id.*
38. *Id.* at 1359.
39. *Id.*
40. *See Leapfrog Enterprises, Inc. v. Fisher-Price, Inc.*, 485 F.3d 1157, 1161 (Fed. Cir. 2007).
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.* at 1163.
45. *See Agrizap Inc. v. Woodstream Corp., 520 F.3d 1337* (Fed. Cir. 2008).
46. *Id.*
47. *Id.* at 1344.
48. Id.
49. *Id.*
50. *See* MPEP §§ 2142-2143.
51. *Id.*

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Speak No Evil (Don't Even Hint at It): Declaratory Judgment Jurisprudence after *Medimmune*

Until the Supreme Court's decision in *Medimmune, Inc. v. Genentech, Inc.*[1], the process whereby a licensee could challenge a patent's validity during the term of the licensing agreement was quite clear. Under the test established by the U.S. Court of Appeals for the Federal Circuit ("the Federal Circuit"), a case or controversy existed where the patent owner's conduct created on the part of the licensee a reasonable apprehension of suit, perhaps in a case where the licensee was continuing to make or use the patented invention without the requisite payment.[2] This prong of the test also took into account the "totality of the circumstances" surrounding the patent owner's actions, where a court would consider all actions on the part of the patent owner, even though the patent owner had not expressly threatened to file suit for infringement.[3] Under the second part of the test, the court would look to see if the licensee actually produced or was preparing to produce the infringing device.[4] This second prong required that the licensee have a "true interest to be protected by the declaratory judgment."[5]

In *Medimmune*, however, the Supreme Court effectively invalidated the Federal Circuit's two-prong test for the Article III case-or-controversy determination in declaratory judgment ("DJ") actions.[6] In the case, a potential patent owner entered into a licensing agreement that covered a pending patent application. When the patent issued, the patent owner claimed that the licensee owed royalties. Though the licensee asserted that the patent was invalid and that no royalties, therefore, were due, the licensee viewed the letter as a threat of litigation on the part of the patent owner. The licensee chose to continue to pay the royalty under protest and filed a declaratory judgment action seeking a finding of invalidity.

The Supreme Court in *Medimmune* discarded the Federal Circuit's jurisprudence, holding that the case-or-controversy threshold can be met by a licensee seeking a declaratory judgment on patent invalidity even where the licensee has not first repudiated the licensing agreement. The Court focused on the coercive nature of forced licensing payments, and held that this provided a case or controversy suitable for Article III adjudication.[7]

Yet, *Medimmune* also injected further uncertainty into the field of patent licensing. The Court did not address the legality of non-challenge clauses, so-called "auto-repudiation" clauses, whereby any challenges to a patent's validity on the part of the licensee could be considered by the licensor to be an act of repudiation. Although *Medimmune* lowered the bar for licensees seeking patent invalidations, the Court stopped short of providing licensees with a wholly independent cause of action. While the Court allowed that an action could proceed even in cases where the licensee is not under a reasonable apprehension of imminent suit, the Court limited justiciability by only allowing those licensees who could meet the burden of showing a pattern of conduct on the part of the patent owner that would suggest the existence of a case or controversy. Rather than requiring a so-called "smoking gun" in the form of a threat of litigation, the Court reasoned that a case or controversy could be established by a fact-specific evaluation of the totality of the circumstances. The inherent danger in such an analysis is a disparate weighing of similar facts within different cases by different federal district courts.

In the Federal Circuit's first case following *Medimmune*, the court established its new standard for the case-or-controversy determination. In *SanDisk v. STMicroelectronics*, a patent owner met with a competitor to discuss the competitor's possible cross-licensing of the patent owner's patents.[8]
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During the course of the meeting, the competitor gave a presentation that was an infringement analysis, referring to the competitor's literal infringement of the patents at issue. Representatives of the patent owner claimed, however, that they had no intention of suing the competitor for infringement. While prior to *Medimmune* such a declaration would likely have denied the competitor standing, here the court held that a case or controversy existed between the two parties.[9] The court reasoned that the conduct of the patent owner in asserting its rights, coupled with the competitor's belief that it had a right to manufacture its products without licensing the patent owner's technology, was enough.

Thus, the Federal Circuit's new test still required that the patent owner take some action manifesting intent to assert its patent rights.[10] On the part of the DJ plaintiff, the court required some sort of affirmative act demonstrating that the plaintiff could produce or prepare to produce the infringing device without a license.

In *Benitec Australia, Ltd. v. Nucleonics, Inc.*[11], the Federal Circuit further defined and refined its new threshold test for cases and controversies. In this case, the declaratory judgment plaintiff was preparing to manufacture a product covered under the defendant's patents, but the product had not been produced at that time. The patent owner sought and obtained a dismissal, having also in the interim issued a covenant not to sue for the plaintiff's infringing activities "occurring on or before the date dismissal was entered in this action."

On appeal, the Federal Circuit upheld the lower court's ruling, emphasizing that meeting the jurisdictional requirements was just the first step of the DJ plaintiff's ongoing burden to show the existence of a case or controversy. If, at any time during the litigation, the subject matter of the controversy is eliminated, the court reasoned that the plaintiff should lose its standing. In this case, the court found that any putative controversy would be years in the future; therefore, the court concluded that the requisite "sufficient immediacy and reality" for declaratory judgment jurisdiction was lacking, and that the defendant's subsequent promise not to sue mooted the controversy.

The Federal Circuit's decision in *Benitec* further refined the *Medimmune* test by emphasizing the standing requirements of both ripeness and lack of mootness as being necessary for DJ plaintiffs to meet. In *Benitec*, the controversy was not yet ripe, as the alleged infringing activity was to occur years in the future; and the controversy was mooted with regard to other patents because the defendant provided the plaintiff with a covenant not to sue with respect to the disputed patents.

Thus, neither the Supreme Court nor the Federal Circuit has articulated a clear test for courts to apply in deciding on the threshold for existence of cases or controversies suitable for adjudication in patent cases. This gap has led to differing interpretations among the district courts concerning the elements that a party seeking declaratory judgments needs to show in order to establish standing.

For example, in *FieldTurf USA, Inc. v. Sports Construction Group, LLC*[12], the District Court for the Northern District of Ohio concluded that a covenant not to sue did not divest the court of jurisdiction over the patent-invalidity declaratory action sought by the plaintiffs.

In *FieldTurf*, a patent owner sued a competitor for infringement, and the competitor filed counterclaims seeking declaratory

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One of the by-products of *Medimmune* has been a renewed emphasis, on the part of patent owners, on the careful drafting of patent licenses.

judgments for non-infringement and patent invalidity. During the course of litigation, the patent owner voluntarily dismissed the infringement claims without prejudice and gave the plaintiff a written covenant not to sue. This covenant was to cover past and present infringement at one location where the plaintiff had used the patent owner's invention. There was no language in the covenant that protected the competitor from future infringement actions. Based on the dismissal of the infringement suit and the covenant not to sue, the patent owner moved the court to dismiss the declaratory judgment counterclaims.

The court in *FieldTurf* reasoned that an unconditional covenant not to sue was necessary to divest a court of declaratory judgment subject matter jurisdiction. The district court distinguished the case from the Federal Circuit's decision in *Benitec* because the promise not to sue in the earlier case was somewhat unconditional. Furthermore, in *Benitec*, the declaratory judgment plaintiff had not engaged in any potentially infringing activities, such as offering to sell or actually selling a commercial product, at the time the suit was filed.

In comparison, in *WS Packaging Group, Inc. v. Global Commerce Group, Inc.*[13], a competitor sought a declaratory judgment of non-infringement after the patent owner threatened to sue the competitor's customers. The patent owner brought a motion to dismiss for lack of declaratory judgment standing. The patent owner also executed a waiver equivalent to a covenant not to sue, in which the patent owner promised not to sue the competitor for any and all past infringement up until the date of the waiver's filing. Upon execution of the waiver, the patent owner made it clear that the waiver was not intended to waive any right to sue for future acts of infringement. The district court did not find the waiver sufficient.

The patent owner responded with a more expansive waiver from any and all future infringement of the patent at issue. The waiver was non-transferable and applied only to the plaintiff and not to any of the plaintiff's current or future sub-licensees. Once again, the district court refused to dismiss the suit, finding that the plaintiff was still under a "reasonable apprehension of imminent suit."[14] The court reasoned that the threat remained because the patent owner still had possible causes of action against the plaintiff's customers. Following the court's ruling, the patent owner provided the court with yet another covenant, this one protecting the plaintiff and plaintiff's customers from suit for infringement of the patent at issue, though the covenant was still non-transferable to future sub-licensees.

The court once again found this insufficient to divest the court of jurisdiction, reasoning that the lack of release for future customers and sub licensees established the requisite case or controversy for the plaintiff's declaratory judgment action.[15] The court felt that this was a type of indirect coercion meant to induce the plaintiff's customers to pressure the plaintiff for resolution, and that these types of pressure tactics created a case or controversy. The case is notable, of course, for the repeated efforts of the patent owner to contract its way out of court, and for the court's refusal to dismiss. Here, the district court balanced the "future harm" ripeness with the "all circumstances" test in finding that the past conduct of the patent owner established imminent future harm.

As can be expected, one of the by-products of *Medimmune* has been a renewed emphasis, on the part of patent owners, on the careful drafting of patent licenses. A "contest and be terminated" clause may no longer hold up. Alternatives with penalties to the licensee short of termination are now appearing in licenses. Some district courts have interpreted the *SanDisk* decision as articulating a new standard that relies on a more wide-open examination of patent-owner conduct. Where a patent owner takes any action that could be construed as a step towards the creation of a case or controversy, the *SanDisk* decision suggests that the Federal Circuit will find Article III jurisdiction. In short, the world has become a little more uncertain for patent holders trying to enforce their rights.

Editor's Note: This article is an abridged version of a much more comprehensive treatment concerning patent licensing in the wake of *Medimmune*, published online at Patent Docs. Visit www.patentdocs.org and click on "Licensing" on the right-hand side of the homepage.

Endnotes:

1. *Medimmune, Inc. v. Genentech, Inc.*, 127 S.Ct. 764 (2007).
2. *Arrowhead Indus. Water, Inc., v. Ecolochem, Inc.*, 846 F.2d 731, 736 (Fed. Cir. 1988).
3. Michael A. Ladra and Lillian Ewing, *Declaratory Judgment Practices After SanDisk v. STMicroelectronics*, 24 SANTA CLARA COMPUTER & HIGH TECH. L.J. 185, 188 (2007).
4. *Id.*
5. *Arrowhead*, 846 F.2d at 736.
6. *Medimmune*, 127 S.Ct. at 764.
7. *Id.* at 773. Under the Court's precedent in *Altvater v. Freeman*, a case or controversy is found where "payment of a claim is demanded as of right and where payment is made, but where

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the involuntary or coercive nature of the exaction preserves the right to recover the sums paid or to challenge the legality of the claim." *Altvater v. Freeman*, 63 S.Ct. 1115, 1119 (1943).

8. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1374 (Fed. Cir. 2007).
9. *Id.* The Federal Circuit held: [W]here 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 declaration of its legal rights. *Id.* at 1381.
10. *Id.* at 1380. The Federal Circuit reasoned that some sort of affirmative action on the part of the defendant was required to prevent declaratory judgment actions from arising "merely on the basis that a party learns of the existence of a patent owned by another or even perceived such a patent to pose a risk of infringement." *Id.*
11. *Benitec Austl., Ltd. v. Nucleonics, Inc.*, 495 F.3d 1340, 1345 (Fed. Cir. 2007), *cert. denied* 2008 WL 1775071 (April 21, 2008).
12. *FieldTurf USA, Inc. v. Sports Const. Grp, LLC*, 507 F. Supp. 2d 801 (N.D. Ohio 2007).
13. *WS Packaging Group., Inc. v. Global Commerce Group, Inc.*, 505 F. Supp. 2d 561 (E.D. Wis. 2007).
14. *Id.* at 564.
15. *Id.* at 565. The court also cited the patentee's "bragg[ing] in a trade magazine of [the patentee's] habit of threatening to sue (or actually suing) the customers of allegedly infringing ven dors or manufacturers, presumably as a means of pressuring the parties to cease their activities or sign a license agreement." *Id.* at 565-66.

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