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## License To Lawsuit: The Path Grows Shorter

*Law360, New York (June 02, 2009)* -- Conventional wisdom regards a consensual, negotiated patent license agreement — or an invitation by the patent owner to enter into such an agreement — as a means to avoid or preempt litigation concerning the underlying patent.

Until recently, case law, notably including settled precedent in the Federal Circuit Court of Appeals, supported that view. But a series of Supreme Court cases, extended by a chastened Federal Circuit, have changed the landscape dramatically.

No longer must a licensee breach or terminate a license agreement as a precondition to challenging the licensed patent in court. Nor must a third party receive an overt threat of infringement litigation in order to have standing to sue to invalidate the patent.

The implicit threat inherent in the patentee's invitation to negotiate a patent license may be enough, even where the patentee disavows any present intention to file suit.

These cases also evince an evolving judicial attitude toward patent interpretation and enforcement that, in significant respects, is less hospitable and more restrictive toward patentees than in times past.

The upshot is that patentees involved in licensing their inventions should be alert to the enhanced risk of being drawn into patent litigation not of their choosing, and of increased challenges to vindicating and enforcing their patent rights in court.

### **Availability of Declaratory Relief**

Prior to the Supreme Court's decision in *Medimmune Inc. v. Genentech Inc.*,<sup>[1]</sup> the rule was that a patent licensee in good standing could not simultaneously maintain its rights under the license and sue for a declaratory judgment challenging the validity, enforceability or scope of that patent.

As articulated by the Court of Appeals for the Federal Circuit (charged with appellate jurisdiction over all patent cases) in *Gen-Probe Inc. v. Vysis Inc.*,<sup>[2]</sup> there was no actual “case or controversy” meeting the Article III requirement for federal court jurisdiction where the licensee had not breached or terminated the license.

In *Medimmune*, the Supreme Court shot down the *Gen-Probe* reasoning. It held that a licensee who believes the licensor is interpreting the scope of the patent (and corresponding royalty obligations) too broadly, or that the patent itself may be invalid, may pay the royalties under protest, preserving its licensed rights, and immediately sue for declaratory relief to adjudicate the licensee’s interpretation of the patent’s scope or validity.

The eight-justice majority found a genuine “case or controversy” existed because, were the licensee required to first breach or terminate the license as a precondition to suit, it would be exposed to a treble damages infringement action and possible loss of the right to practice the patent.

The court analogized this to the precedents authorizing an immediate declaratory judgment suit to challenge an unconstitutional law, without requiring plaintiff to first break the law and be exposed to criminal penalties.

With its *Gen-Probe* reasoning thus rebuked, the Federal Circuit, only three months after *Medimmune*, took the logic of that decision one major step further.

In *Sandisk Corporation v. STMicroelectronics Inc.*,<sup>[3]</sup> the Court of Appeals found that a genuine case or controversy supporting a declaratory judgment action exists where a patentee invites a third party to enter into negotiations for a license, and advises that absent a license, the third party may be infringing the patent.

In *Sandisk*, the patentee affirmatively said, in writing, that it had no present intention to file an infringement action. Nevertheless, the mere risk that the patentee might change its mind was found to be sufficient to allow the other party to file its declaratory judgment action.

The patentee defendant in *Sandisk* had presented a detailed infringement analysis as part of the initial license negotiations, which created some tension with its profession of no intent to sue. However, as noted in a concurring opinion, it will be difficult to limit the reach of *Sandisk* and *Medimmune* to their particular facts.

Every invitation to consider taking a patent license necessarily implies that the potential licensee’s current or proposed conduct would constitute infringement without the license — otherwise why would any licensee agree to pay royalties?

So a patentee must know that any suggestion that a third party consider a license may be enough to allow that party to immediately sue for a declaratory judgment challenging that patent.

## The Test for “Obviousness” Relaxed

In order to qualify for patent protection, an invention must (among other things) be “nonobvious.” That is, the subject matter of the patent must be sufficiently different from the prior art that the invention would not be obvious to one having ordinary skill in the field.

The obviousness analysis is particularly significant where an invention consists of a combination of several preexisting elements or concepts, each of which may be well known, but the combination of which is claimed to be novel.

The Federal Circuit, seeking to bring more uniformity and predictability to the obviousness analysis, had developed what came to be known as the “teaching, suggestion or motivation” test (TSM).

Under the TSM test, a patent claim would only be found obvious if some suggestion or motivation to combine the preexisting elements, and thereby solve the problem addressed by the invention, could be found in the related scientific, academic or professional literature, or in the nature of the problem itself.

In *KSR International Co. v. Teleflex Inc.*,<sup>[4]</sup> the Supreme Court again cast off the Federal Circuit’s rule, finding that TSM was too rigid and formalistic, and hence likely to sustain patents that, properly construed, were in fact obvious.

The Federal Circuit, applying TSM, had held that courts and patent examiners should only look to the problem the patentee was trying to solve to judge whether the resulting solution was obvious in light of prior art.

It also held that only those elements of prior art that were themselves designed to solve the patentee’s problem were relevant. And it held that obviousness could not be predicated on a finding that the combination of elements was “obvious to try.”

KSR expressly rejected each of these TSM premises, and mandated that the obviousness analysis must be applied flexibly, without arbitrarily ruling out any relevant prior art from consideration.

If it would have been obvious to one having ordinary skill in the field to combine preexisting elements to solve the problem at hand, whether or not those elements had themselves been conceived with the same problem in mind, the invention is obvious and not patentable.

The outcome of the new KSR obviousness rules in any given case will turn on the particular facts. But it is fair to say that the prospects for successfully challenging as obvious any patent consisting of an allegedly novel combination of preexisting elements — business methods patents being prominent examples of such — are considerably enhanced by the ruling in KSR..

## Permanent Injunctions and Treble Damages Become Harder to Get

The sobering news for patent owners does not stop with looser rules for initiating patent challenges, and greater risk of cancellation based on obviousness.

Long-standing precedents governing the availability of permanent injunctions and of treble damages for infringement have fallen as well, increasing the hurdles that even a successful patent plaintiff must overcome to secure maximum relief.

The Federal Circuit, in the matter of *In Re Seagate Technology LLC*[5], overruled its own well established rule imposing upon a potential infringer “an affirmative duty to exercise due care to determine whether or not he is infringing.”[6] Failure to adhere to this duty of care would expose the infringer to treble damages for “willful infringement.”

Seagate reexamined this rule, and concluded that it had been error to premise potential exposure to treble damages upon conduct that is merely negligent. The court held that henceforth, an infringer must be guilty of at least reckless disregard of the patentee’s rights to suffer treble damages.

It also held that a patentee’s right to treble damages for purely post-litigation willful infringement would be contingent upon the patentee seeking and obtaining a preliminary injunction.

And finally, in another rebuke to the Federal Circuit, the Supreme Court in *eBay Inc. v. MercExchange LLC*[7] overruled the Federal Circuit’s “general rule” that a permanent injunction against further patent infringement should be granted to a successful patent plaintiff “absent exceptional circumstances.”

The court held that patents are entitled to no such special protection, and that a successful patent owner seeking a permanent injunction must satisfy the same four-factor test traditionally applied to all other claims for such equitable relief.[8]

Perhaps more ominous for patent owners than the substance of this ruling, is the explanation in Justice Kennedy’s concurring opinion for why this holding comports with changing commercial realities.

He acknowledges that permanent injunctions were almost automatic in earlier cases, but adds that in most such cases the patent plaintiff was actually practicing the invention.

Therefore, injunctive relief was warranted, even under the four factor test, because the patent owner needed to exclude the infringer from continuing to use the invention in order to protect its own business activities.

He then observes that “An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees.”[9]

For such firms, “an injunction ... can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent.”[10] For such enterprises, legal damages may well be sufficient, and an injunction may be against the public interest.

This brief passage aptly reflects a growing judicial concern about the negative consequences, for commerce and the public at large, of the overreaching and predatory “patent troll” phenomenon.

It is no doubt true that some patent portfolio licensors have been guilty of great excesses in their efforts to enforce and monetize their patent rights.

True also that the explosion of “business methods” patents, particularly (though certainly not exclusively) in the Internet space, has yielded a bumper crop of issued patents that are dubious at best. Judicial “pushback” against these detrimental developments is predictable and appropriate.

But this tide impacts the responsible licensor of a blue chip patent as well as the malefactor. So all patent owners who are engaged in or considering a licensing program must be aware of the evolving legal landscape and the accompanying risks and challenges.

## **What To Do?**

As discussed above, current law makes the risk of a declaratory judgment lawsuit challenging one’s patent a virtually inevitable concomitant of any licensing activity.

The first and most obvious action item for any patent owner, before engaging in any potentially triggering activity, is to exercise due diligence that the patent in question has a high likelihood of overcoming any such challenge, and that the scope of the patent fairly encompasses the existing or proposed license grant.

Thus, for example, before proposing a new license, or asserting that an existing license covers the licensee’s new product, the patentee should have competent patent counsel confirm the integrity of the patent.

This should specifically include, in appropriate cases, that the patent is likely to survive an obviousness challenge under current law. Do not send up a “trial balloon” if you are not prepared for it to blow up into a lawsuit.

Similarly, a patentee is well advised to be conservative in seeking to secure new licenses or to extend the scope of existing ones. The prospect for additional incremental

royalty income should be weighed thoughtfully against the cost and risk of defending a declaratory judgment suit.

Finally, the patentee may be able to avoid, or at least to defer, a declaratory judgment action by seeking to have the potential licensee execute a confidentiality agreement at the outset of communications.

Such an agreement would recite that the discussions and disclosures are intended exclusively to support discussions toward a voluntary business agreement, and that neither party will rely on such negotiations, whether successful or otherwise, as grounds for initiation of a declaratory judgment lawsuit.

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*The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.*

[1] 549 U.S. 118 (2007)

[2] 359 F.3d 1376 (Fed. Cir. 2004)

[3] 480 F.3d 1372 (Fed. Cir. 2007)

[4] 550 U.S. 398 (2007)

[5] 497 F.3d 1360 (Fed. Cir. 2007)

[6] *Underwater Devices Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389-90 (Fed. Cir. 1983).

[7] 547 U.S. 388 (2006)

[8] The four factors are: (1) irreparable injury, (2) inadequacy of legal remedies, (3) balance of hardships favors the movant, and (4) the injunction will not disserve the public interest.

[9] *eBay v. MercExchange*, 547 U.S. at 396 (2006)

[10] *Id.*