



## INITIATING LICENSING DISCUSSIONS AFTER SANDISK & SEAGATE: WHAT IS A PATENT OWNER TO DO?

*Jack is in-house counsel for Acme Technology Corporation. After years of wrangling with the United States Patent & Trademark Office ("PTO"), Acme was awarded a patent on a key technology; and in the years the application has been pending in the PTO, the technology has become widely adopted in the industry. Jack's CEO just called him into a meeting and tasked Jack with convincing the major industry players to start paying royalties on Acme's newest asset.*

*Jack has been through this process before with a different patent, so when he returns to his office, he dusts off a copy of a form letter he sent to the industry two years ago. The letter states, in part:*

*Enclosed for your consideration is a recently issued patent assigned to Acme Technology Corporation. We believe that [XYZ Company] is infringing one or more claims of the patent. We are willing to license the patent on reasonable terms. Please contact me as soon as possible so that we can discuss licensing.*

*Jack recalls that he was previously advised this type of letter would meet his three goals to: (a) trigger meaningful licensing discussions; (b) put the recipient on sufficient notice of the patent so that the threat of willful infringement (and treble damages) would be available; and (c) avoid the possibility of a declaratory judgment action being filed against Acme. Just as Jack is about to revise the letter for the new patent, he decides to call outside counsel to make sure nothing has changed since the last time he went through this drill. The answer Jack hears is that everything has*

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*changed and that sending his old form letter likely will not accomplish any of his three goals.*

## **Overview**

More than a year after the Federal Circuit's *SanDisk* and *Seagate* decisions, the licensing landscape for patent owners, licensees, and potential licensees is still unsettled. First, *SanDisk* set forth a new test to determine whether a potential licensee can establish jurisdiction to bring a declaratory judgment action against a patent holder.<sup>i</sup> Then, *Seagate* created a more stringent measure for willful patent infringement.<sup>ii</sup> For patent holders, *SanDisk* and *Seagate* create a difficult tension.

Prior to *SanDisk*, a potential licensee needed to show it was under a "reasonable apprehension of suit" by the patent owner in order to bring a declaratory judgment action. In *SanDisk*, the Federal Circuit instead established a new two-part test, holding that declaratory judgment jurisdiction exists where: (1) a patent owner asserts rights under a patent based on certain identified ongoing or planned activity by a potential licensee, and (2) the potential licensee contends it does not need a license.<sup>iii</sup> As a result, in *SanDisk* the Federal Circuit found that the potential licensee was justified in bringing a declaratory judgment action against the patent owner.

*Seagate*, meanwhile, dramatically raised the bar for proving willfulness.<sup>iv</sup> No longer does a party with actual notice of a patent have an affirmative duty to determine whether or not it infringes. Rather, the burden to prove willful infringement has been

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placed back on the patentee. Prior to *Seagate*, the Federal Circuit held in *Underwater Devices, Inc. v. Morrison-Knudsen, Inc.* that an accused infringer has an “affirmative duty to exercise due care to determine whether or not he is infringing.”<sup>v</sup> *Seagate*, however, overruled *Underwater Devices* and held “that proof of willful infringement permitting enhanced damages requires at least a showing of objective recklessness.”<sup>vi</sup> In other words, “to establish willful infringement, [*inter alia*,] 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.”<sup>vii</sup>

Arguably, a patentee increases the likelihood of later proving “objective recklessness” by providing as much detail as possible to a potential licensee about: (a) the product the patentee believes is infringing; and (b) the claims the patentee believes are infringed. For example, in *SanDisk*, the patent owner provided lengthy written claim charts, reverse engineering reports, and analysis detailing alleged infringement.<sup>viii</sup> As *SanDisk* itself proves, however, that very type of activity opens the door to declaratory judgment actions.

So what should Jack do? Is it possible to accomplish all three of his goals? This paper explores some possible approaches and discusses the recent trial court decisions applying *SanDisk*. As will be explored herein, the exact parameters of what a patent holder can safely say, write, or do, without triggering declaratory-judgment jurisdiction,

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is very much in flux; and a patentee's actions in trying to preserve a willful infringement claim may well be the same actions that trigger such jurisdiction.

By way of illustration, discussed below are four (of many) options that Jack could pursue for Acme.

***Option # 1: Jack sends his form letter.***

Before *SanDisk* and *Seagate*, this was accepted practice. Today, this approach is not recommended. Recall that Jack's form letter encloses a copy of the patent and simply states "*We believe that [XYZ Company] is infringing one or more claims of the patent.*" As discussed above, although this may be sufficient to prompt the recipient to agree to a licensing discussion, it is unlikely that the letter alone will be sufficient under *Seagate* to invoke the specter of willful infringement. Moreover, it appears under the *SanDisk* test that the recipient may well be able to sue for declaratory judgment of non-infringement based on Jack's statements in the letter.

In *SanDisk*, the patent owner held numerous meetings with the potential licensee to discuss licensing terms and provided detailed infringement allegations, including presenting lengthy written analyses of infringement to the potential licensee. Post-*SanDisk* courts, however, have been forced to apply the new test for declaratory judgment jurisdiction in scenarios that are not as clear cut as the facts in *SanDisk*. Generally, these decisions have focused on statements made by the patent owner, the

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conduct of the patent owner, and litigation related to the patent and/or patent owner.

Although the edges of what clearly will or will not cause declaratory judgment jurisdiction to arise are becoming clearer, there remains a vast middle ground of conduct for which the consequences are still being defined.

For example, jurisdiction has been found in cases that involve considerably less aggressive patentee conduct than in *SanDisk*. In *EchoStar Satellite LLC v. Finisar Corp.*, statements made by the patent owner, in combination with the patent owner's litigation conduct against another party, gave rise to declaratory judgment jurisdiction.<sup>ix</sup> In finding jurisdiction, the court relied on: (a) a letter from the patent owner informing the potential licensee that it was "utilizing various aspects of their patent for a substantial length of time"; (b) the fact that licensing negotiations were ongoing; and (c) a press release from the patent holder after winning a separate litigation against a third party that it was the patent owner's intention to continue licensing discussions with other companies.<sup>x</sup> Similarly, in *Sabert Corp. v. Waddington N. Am., Inc.*, the court found jurisdiction existed based on a letter from the patentee taking "a clear position that if the product ... was not produced in a manner exactly the same as the prior art, then the product would be considered as infringing on the patent."<sup>xi</sup> The court further concluded that "this position, whether reached on observation or on a three hundred page report [(a veiled reference to the facts of *SanDisk*)], is what creates the controversy."<sup>xii</sup>

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Not all lower courts have been as broad in their interpretation of *SanDisk*. Some courts have chosen to read *SanDisk* as more narrowly tied to its own facts.<sup>xiii</sup>

Nevertheless, given that Jack's form letter is almost certainly not going to increase Acme's ability to recover for willful infringement, a definitive but general statement of infringement carries an unnecessary risk of invoking declaratory judgment jurisdiction.

***Option # 2 – Jack Sends Informational Letter.***

Jack could alter his form letter, for example, to state: "*Enclosed is a copy of a recently issued patent assigned to Acme. We thought this patent may be of interest to you. If you would like to discuss this patent, please contact me at your earliest convenience.*" Even post-*SanDisk*, it does not appear that this type of non-threatening communication (which does not make accusations of infringement, mention a particular product, or suggest a need to license the patent) would support declaratory judgment jurisdiction.

For example, in *Innovative Therapies*, the potential licensee contacted the patent owner via phone regarding the potentially infringing product.<sup>xiv</sup> The patentee (KCI) stated that it would "act aggressively upon Innovative's launch of [its product]."<sup>xv</sup> However, the court rejected declaratory judgment jurisdiction because KCI responded that "such [aggressive] action would take place only after KCI determined that the product infringed the KCI patents."<sup>xvi</sup> The court thus held that this and similar

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statements left a degree of contingency that rendered them something less than the “affirmative act” that is “required by *SanDisk*.”<sup>xvii</sup>

Similarly, in *Wooster Brush*, the patent owner (Bercom) sent the potential licensee (Wooster Brush) a letter indicating that Bercom “owns several patents covering its [(Bercom’s)] developed products, and has numerous pending patent applications[.]”<sup>xviii</sup> The letter concluded that Bercom would “take whatever steps it deems to be appropriate to protect its intellectual property rights.”<sup>xix</sup> The court rejected declaratory judgment jurisdiction by distinguishing *SanDisk* and stating that “there is no evidence [that the patent owner] has made a demand ... that identifies how any new product infringes specific claims of any of [the] patents...nor is there any evidence that [the patent owner] has asserted that [the potential licensee is] engaged in present, ongoing infringement of ... [the] patent, or demanded that [the potential licensee] license the patents, as occurred in *SanDisk*.”<sup>xx</sup>

Accordingly, it would appear that even post-*SanDisk*, an “informational letter” that does not make an allegation of infringement or suggest the need for a license will not, by itself, create jurisdiction for a declaratory judgment action. It goes without saying, however, that this letter is even less effective in assisting a willfulness claim; moreover, this type of letter may not even prompt a recipient to engage in licensing discussions at all.



If Jack does send an informational letter and the recipient responds, Jack will almost certainly want to obtain a “standstill agreement” (an agreement that neither party will file suit against the other) during the period of license negotiations. Additionally, as part of any “standstill agreement,” Jack should include a provision stating that discussions and any information exchanged between Jack and the recipient shall be treated as compromise and settlement negotiations for purposes of Rule 408 of the Federal Rules of Evidence. Otherwise, much like in *SanDisk* itself, Acme’s statements or actions during licensing negotiations could later trigger declaratory judgment jurisdiction.

***Option # 3 – Jack Sues One Potential Licensee, But Not All.***

Jack could choose to sue rather than pursue initial licensing negotiations. This option eliminates the possibility of a declaratory judgment action in an inconvenient forum with respect to the party being sued. In this example, Jack decides initially to sue only one party from his list of alleged infringers. Strategically, this allows Jack to attack the weakest or most-likely-to-settle infringer first, thereby laying the framework for an established royalty rate and/or a litigation war chest. Post-*SanDisk*, however, this approach could lead to declaratory judgment actions filed by other industry players in inconvenient forums.



For example, in *Delphi*, the patent owner (ATI) filed a patent infringement lawsuit against the customers of the potential licensee (Delphi).<sup>xxi</sup> In finding declaratory judgment jurisdiction, the *Delphi* court held that though the defendant's prior claim was not aimed "directly at Delphi ... [the patent owner] evinces a similar preparedness and willingness to enforce its patent rights" and that Delphi bears a direct responsibility for and relationship to the challenge ATI lodged in the other suit.<sup>xxii</sup>

The risk of declaratory judgment is heightened if Jack sends even informational letters to the other industry players that Acme has not yet sued. For example, in *Crutchfield New Media*, the patent owner (Hill) provided the potential licensee (Crutchfield) with a letter and package giving, "information about the content of its patents, their file histories... summary of the licensees and coventees [sic] of Hill under the patents in suit, and a summary of the extent to which Hill had litigated its right to the exclusive use of the patented technology."<sup>xxiii</sup> The *Crutchfield* court found declaratory judgment jurisdiction existed for Crutchfield, stating that "[Hill's] letter makes clear that, as an Internet retailer, Hill put Crutchfield in the same category as other Internet retailers against whom Hill had filed a patent infringement suit."<sup>xxiv</sup>

Accordingly, to avoid declaratory judgment jurisdiction, Jack may want to consider filing suit against all the alleged infringers at once. That option, however, is potentially the most expensive and also serves to set an immediately adversarial tone that may stall what otherwise might have been productive licensing negotiations.

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***Option #4 – Jack “Pocket Files” vs. All Potential Licensees and Sends Detailed Letters.***

Although there can be no guarantees in the unsettled, post-*SanDisk* climate, this is perhaps the safest route to meet all three of Jack's goals to (a) trigger licensing negotiations; (b) increase the potential for a willfulness claim; and (c) avoid facing a declaratory judgment action in an inconvenient forum. First, Acme “pocket files” (files but does not serve) infringement claims against all potential infringers. Then Jack sends detailed letters (e.g., claim charts, reverse engineering reports, analyses) to each alleged infringer and invites them to engage in licensing discussions. Acme will have 120 days to serve the complaints on the potential licensees after they are filed.

By sending detailed analyses to the alleged infringers, Acme increases its chances of success on a willfulness claim for ongoing activity. In addition, since Acme pocket filed against all infringers before sending the letters, any later-filed declaratory judgment actions filed will likely be dismissed based on the first-to-file rule, so long as Acme ultimately serves the complaints in time. Also, by not serving the complaint initially, Acme avoids putting all the potential licensees into an immediately adversarial posture (though some potential licensees may not distinguish between a suit filed but not served). Jack then has 120 days to negotiate licenses before complaints would need to be served. During that time, if licenses are not ultimately executed, Jack can make decisions whether to serve the complaints or enter into standstill agreements with

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the potential licensees to continue negotiations. Either way, by pocket filing, Jack is negotiating from a position of strength.

## **Conclusion**

Ultimately, after *SanDisk* and *Seagate*, initiating licensing discussions is a little like crossing a busy road. Walking up to the curb (e.g., sending informational letters) is safe but does not accomplish much. Crossing all the way over the road (e.g., suing all potential infringers), though it has some risk, can be accomplished with careful planning (e.g., pocket filing and sending detailed letters). But going part way (e.g., sending accusatory letters) is eventually going to lead to an unwanted result. The appropriate route to take will always depend on the particular circumstances, personalities, and parties involved; however, it is clear that *Seagate*, *SanDisk* and recent lower court cases should be carefully considered when charting a course for a licensing initiative.

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<sup>i</sup> For a synopsis of *SanDisk*, see *Recent Federal Circuit SanDisk Decision Broadly Applies MedImmune, Giving Potential Licensees New Leverage*, The M&G Edge: M&G's Intellectual Property White Paper, May 2007, available at [www.merchantgould.com](http://www.merchantgould.com).

<sup>ii</sup> For a synopsis of *Seagate*, see *In Re Seagate, Willful Infringement, Advice of Counsel and Waiver*, The M&G Edge: M&G's Intellectual Property Whitepaper, November, 2007, available at [www.merchantgould.com](http://www.merchantgould.com).

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- <sup>iii</sup> *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372 (2007).
- <sup>iv</sup> *In re Seagate Technology LLC*, 83 U.S.P.Q.2d 1865 (Fed. Cir. 2007) (en banc).
- <sup>v</sup> *Underwater Devices, Inc. v. Morrison-Knudsen, Inc.*, 717 F.2d 1380, 1390 (Fed. Cir. 1983).
- <sup>vi</sup> *Id.* at 1870.
- <sup>vii</sup> *Id.* (emphasis added).
- <sup>viii</sup> *Id.* at 1382-83.
- <sup>ix</sup> See, e.g., *EchoStar Satellite LLC v Finisar Corp.* (D. Del. 2007) 515 F Supp 2d 447,449.
- <sup>x</sup> *Id.* at 449.
- <sup>xi</sup> *Sabert Corp. v. Waddington N. Am., Inc.*, Civ. A. No. 06-5423, 2007 U.S. Dist. LEXIS 68092 at\*3-5 (D.N.J. Sept. 14, 2007).
- <sup>xii</sup> *Id.* at 10-11.
- <sup>xiii</sup> See e.g., *Innovative Therapies, Inc. v. Kinetic Concepts, Inc.*, 2008 U.S. Dist. LEXIS 53290 \*at 5-6 (D. Del. July 14, 2008); and *Wooster Brush Co. v. Bercom Int'l, LLC*, 2008 U.S. Dist. LEXIS 29971at\*5-6 (N.D. Ohio Apr. 11, 2008) (discussed herein).
- <sup>xiv</sup> *Innovative Therapies, Inc. v. Kinetic Concepts, Inc.*, 2008 U.S. Dist. LEXIS 53290 \*at 5-6 (D. Del. July 14, 2008).
- <sup>xv</sup> *Id.* at 22.
- <sup>xvi</sup> *Id.*
- <sup>xvii</sup> *Id.*
- <sup>xviii</sup> *Wooster Brush Co. v. Bercom Int'l, LLC*, 2008 U.S. Dist. LEXIS 29971at\*5-6 (N.D. Ohio Apr. 11, 2008).
- <sup>xix</sup> *Id.*
- <sup>xx</sup> *Id.* at 11-12.
- <sup>xxi</sup> *Delphi Corp. v. Auto. Techs. Int'l*, 2008 U.S. Dist. LEXIS 56463 at\*1-2 (E.D. Mich. Jul. 25, 2008).
- <sup>xxii</sup> *Id.* at 9-10.
- <sup>xxiii</sup> *Crutchfield New Media, LLC v. Charles E. Hill & Assocs., Inc.*, No. 1:06-cv-0837, 2007 U.S. Dist. LEXIS 33264 at\*2 (S.D. Ind. May 4, 2007).
- <sup>xxiv</sup> *Id.* at 5-7.

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