



RECENT FEDERAL CIRCUIT *SANDISK* DECISION BROADLY APPLIES *MEDIMMUNE*, GIVING POTENTIAL LICENSEES NEW LEVERAGE

The Supreme Court's *MedImmune* decision, and the Federal Circuit's interpretation of it in *SanDisk*, changed the landscape of the relationship among patent owners, licensees, and potential licensees. In the wake of these decisions, the following points stand out as noteworthy:

- Patent owners need to be more wary about licensing efforts that may trigger lawsuits against them.
- Licensees encountering aggressive patent owners attempting to expand the scope of current licenses can challenge patents while maintaining their license.
- Parties receiving license proposals or other implied charges of infringement now have grounds to take the initiative and sue patent owners who won't go away.

The Federal Circuit's recent *SanDisk* decision adopted the Supreme Court's *MedImmune* decision and revolutionized the ability to challenge the scope and, perhaps, validity of licensed patents. *SanDisk Corp. v. STMicroelectronics, Inc.*, No. 05-1300 (Fed. Cir. March 26, 2007); *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007). The *MedImmune* decision allows licensees to challenge patents without terminating the license. The *SanDisk* decision appears to allow anyone approached by a patent owner to challenge patents, even absent licensing negotiations or an agreement. Companies may now eliminate the risk of being forced into licensing negotiations or even a license as a prerequisite to challenging a patent. Moreover, companies may also enter into negotiations or a license to

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avoid facing harm well in excess of the royalties, such as trebled damages, attorneys' fees, and an injunction, when challenging a patent.

The Federal Circuit in *SanDisk* recently revisited the requirements for a potential infringer to bring a declaratory judgment action seeking to have the patent declared invalid or not infringed. When a patent owner accuses one of infringement but does not bring suit, sometimes the potential infringer wishes to bring a suit of its own, before being sued for infringement, to resolve the matter. In the past, the Federal Circuit prohibited the potential infringer from bringing suit unless it had a "reasonable apprehension" of being sued by the patent owner. However, the Federal Circuit eliminated this requirement in *SanDisk*, finding that *MedImmune* rejected the "reasonable apprehension" test.

Thus, *MedImmune* and *SanDisk* together will have far reaching effects even in cases involving no license at all. A party may now bring a declaratory judgment action where the patent owner has merely asserted patent rights based on certain ongoing or planned activity of that party, even if the patentee has given no hint of bringing suit. These decisions expand the rights of businesses approached to take patent licenses by giving businesses the right to challenge such patents.

The *MedImmune* case centers on a 1997 licensing agreement, in which MedImmune agreed to make royalty payments related to its respiratory syncytial virus (RSV) drug, Synagis, to Genentech. When Genentech demanded additional royalties in 2001, MedImmune filed a declaratory judgment action while still paying royalties. The District Court and Federal Circuit both dismissed the declaratory judgment action for lack of "case or controversy" because MedImmune was a patent licensee in good standing. At the Supreme Court, MedImmune's luck changed for the better. The Court reversed long-standing Federal

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Circuit precedent, holding 8-1 that a “case or controversy” within the meaning of Article III of the Constitution existed even though MedImmune did not breach the license. The Court held that a licensee such as MedImmune, which faced the loss of 80% of its business if it lost its license, is effectively “coerced” into compliance, and thus should be able to sue for the right not to comply. Just as a citizen need not violate certain laws to challenge them, a licensee need not cease its payment of royalties to create a “controversy” for purposes of a court challenge to patent validity or scope.

In *SanDisk*, the Federal Circuit applied the *MedImmune* holding on March 26, 2007, in a broad fashion. The declaratory judgment plaintiff negotiated at length for a patent license with ST. During negotiations, ST notified SanDisk of SanDisk's infringement of ST's patents, but stated ST “had absolutely no plan whatsoever to sue SanDisk.” Because SanDisk disagreed and did not have a license, it sued ST for a declaratory judgment that the ST patents were invalid, unenforceable and not infringed. The District Court threw out SanDisk's claims for lack of a “case or controversy,” citing the lack of a reasonable apprehension of suit and its discretion to dismiss declaratory judgment claims.

The Federal Circuit vacated and remanded the case based on the *MedImmune* holding. The Federal Circuit noted that *MedImmune* addressed declaratory judgment jurisdiction in the context of a signed license. According to the Federal Circuit, however, *MedImmune* also provides guidance as to what constitutes a sufficient “case or controversy” even without a signed license. While mere knowledge of a patent owned by another does not create declaratory judgment jurisdiction, conduct by a patent owner that puts a potential infringer “in the position of either pursuing arguably illegal behavior or abandoning that which he claims a right to do” may create jurisdiction.

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Because ST sought a royalty under its patents based on SanDisk's activities, jurisdiction existed. ST's denial that it would sue SanDisk failed to eliminate a justiciable controversy because ST showed a "preparedness and willingness" to enforce its patents through its detailed infringement assertions. Under *SanDisk's* application of *MedImmune*, a party may sue upon being approached for a patent license and offer grounds why it does not infringe the patent.

These decisions will have an immediate and powerful impact on relationships between patent owners and potential infringers. Looking forward, the terms of licensing deals and negotiations will likely change significantly after *MedImmune* and *SanDisk*. Patent owners must be certain of their position in negotiations, lest they end up in court before a deal is inked. Patent owners must also be wary of sending "notice" or "cease and desist" letters, as regardless of the language used, such letters will provide grounds for declaratory judgment actions.

These decisions give licensees a new advantage and patent owners an unexpected disadvantage. Licensees can now potentially avoid the risks of losing a patent challenge. Few of the licensing arrangements existing today are likely to have clauses that contemplate the formerly-precluded option of a licensee challenging a patent while paying under the license. Instead, it seems that licensees, who would have been charged higher royalties had the patent owner known the licensee could challenge the patent, and potentially receive a windfall.

One possibly unintended consequence of both decisions is that they may discourage licensing in favor of litigation. A patent owner may feel compelled to bring suit, rather than

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offering a license which could later be challenged. Litigation may be initiated more often before a license is offered because a license entered as part of a settlement may be more likely to avoid future challenges to the patent.

Moreover, patent owners will grow more fearful of preemptive declaratory judgment actions when seeking licensees, even if they have no intention of bringing suit. This too may cause patent owners to sue first, then negotiate. However, once the lawsuit is commenced, it may lead to litigation that would not have occurred otherwise. Litigation also may increase as existing or future licensees decide their downside is so limited that a patent challenge is worthwhile. If the licensee at worst must keep paying the license fee that would have been due anyway, then there is a new incentive to bring suit.

What should patent owners and potential licensees do in a *MedImmune* and *SanDisk* environment? If the goal is to stay out of the courthouse, patentees must tread carefully. It appears patent owners can no longer send "notice" or "cease and desist" letters without subjecting themselves to suit. Patent owners should be prepared to file an infringement action before requesting a license, and patent owners should be certain to mark all products to obviate the need for a notice letter.

If parties have agreed to settle a dispute without litigation, licensing agreements must be drafted to avoid future conflict. One solution is building disincentives to litigate into a license. For example, a patent owner may request a provision that allows for termination of the license if the licensee brings suit, thus reopening the door to treble damages, attorneys' fees, and an injunction if the former licensee continues to practice the patented technology. As another approach, the license may state that a suing licensee's royalty escalates in the

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event of a patent challenge. Another possible arrangement is a preset penalty, such as liquidated damages or trebled royalties and attorney's fees, should the licensee lose the challenge. Such contract provisions would alleviate both the licensee's concern that it is not getting a license to a rightfully patented product and a patent owner's concern that it will be unfairly subjected to suit.

MedImmune and *SanDisk* changed the rules of the patent licensing game. This change may be viewed as part of a more general trend placing more pressure on patent owners. Several amicus briefs filed in *MedImmune* advocated the change to encourage more challenges to the scope and validity of patents. These amici contended that commerce is burdened and innovation stifled by the unchallenged enforcement of unwarranted patents on obvious inventions (such as business methods). Amici further contended that innovation and businesses would benefit by making it easier for licensees to challenge patents. However, the change may also bring unintended consequences, such as more litigation, which also burdens innovation and commerce. Only time will tell whether this change results in helping or harming innovation and commerce.

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