

## Federal Trade Commission Hearing – “The Evolving I.P. Marketplace” December 5, 2008

### Testimony of Professor Joseph Scott Miller, Lewis & Clark Law School

#### • *Legal Doctrines That Affect the Value and Licensing of Patents* (Panel 3)

It is an honor to participate in today’s hearing with so many distinguished panelists, and I thank the Commission for giving me the opportunity to do so.

My focus today is on the U.S. Supreme Court’s January 2007 decision in *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2007), and its consequences. Some of the consequences are concrete and apparent, while others are more speculative. I will focus on three: (1) the Federal Circuit’s approach to declaratory judgment jurisdiction analysis in cases involving not-yet-license-bound parties; (2) license-term responses we are likely to see in post-*MedImmune* deals; and (3) new pressures on how we think about joint defense agreements among those sued, or threatened with suit, for patent infringement.

#### 1. Federal Circuit Analysis After *MedImmune*

The *MedImmune* decision itself dealt with the question whether a licensee in good standing could continue to pay running royalties and, at the same time, bring a declaratory judgment action contesting its obligation to pay on the ground that the licensed patent claim is invalid. The Court concluded that a paying licensee can bring a declaratory judgment action without first having to breach the license:

We hold that petitioner was not required, insofar as Article III is concerned, to break or terminate its 1997 license agreement before seeking a declaratory judgment in federal court that the underlying patent is invalid, unenforceable, or not infringed. The Court of Appeals erred in affirming the dismissal of this action for lack of subject-matter jurisdiction.

127 S. Ct. at 777.

The *MedImmune* facts do not directly pertain to the case where a patentee has signaled that it thinks a potential licensee’s conduct may be infringing, negotiations about whether a license is even needed may be underway, and the potential licensee brings a declaratory judgment action alleging that the asserted patent is invalid or unenforceable or not infringed. Because, however, the Federal Circuit erred in *MedImmune* by applying its then-settled two-step analysis for declaratory judgment jurisdiction – did the d.j. plaintiff have a reasonable apprehension of imminent suit from the patentee, and had it engaged in, or taken concrete steps toward, putatively infringing activity? – the Supreme Court had occasion in *MedImmune* to call that settled Federal Circuit analysis into question. *See MedImmune*, 127 S. Ct. at 774 n.11 (describing that the Federal Circuit’s approach “contradicts” or “conflicts with” multiple Supreme Court decisions).

The Federal Circuit embraced *MedImmune* swiftly and completely. A little more than two months after *MedImmune*, the Federal Circuit applied the Supreme Court’s approach to a case involving a putative infringer – SanDisk – who broke off negotiations with a patentee – STMicroelectronics (“ST”) – and sued for a declaratory judgment of invalidity etc. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372 (Fed. Cir. 2007). Patentee ST urged that the ongoing negotiations proved that SanDisk had no reasonable apprehension of an imminent infringement suit from ST. The Federal Circuit repudiated its prior approach: “The Supreme Court’s opinion in *MedImmune* represents a rejection of our reasonable apprehen-

sion of suit test.” *Id.* at 1380. It focused instead on the parties’ conflicting claims about ST’s asserted right to exclude SanDisk with a patent:

ST communicated to SanDisk that it had made a studied and determined infringement determination and asserted the right to a royalty based on this determination. SanDisk, on the other hand, maintained that it could proceed in its conduct without the payment of royalties to ST. . . . SanDisk need not “bet the farm,” so to speak, and risk a suit for infringement by cutting off licensing discussions and continuing in the identified activity before seeking a declaration of its legal rights.

*Id.* at 1382 (footnote omitted).<sup>1</sup> The Federal Circuit also highlighted that *some* assertive step from the patentee is required to trigger declaratory judgment jurisdiction:

In the context of conduct prior to the existence of a license, declaratory judgment jurisdiction *generally will not arise* merely on the basis that a party learns of the existence of a patent owned by another or even perceives such a patent to pose a risk of infringement, *without some affirmative act by the patentee*. But Article III jurisdiction may be met where the patentee takes a position that puts the declaratory judgment plaintiff in the position of either pursuing arguably illegal behavior or abandoning that which he claims a right to do. We need not define the outer boundaries . . . .

*Id.* at 1380-81 (emphasis added). In short, “once a patentee goes to an alleged infringer and identifies a specific patent and a specific product of the other company, the patentee is immediately at risk of a declaratory judgment action.” Ronald A. Bleeker & Michael V. O’Shaughnessy, *One Year After MedImmune—The Impact on Patent Licensing & Negotiation*, 17 FED. CIR. B.J. 401, 428 (2008).

Two aspects of the Federal Circuit’s new approach are noteworthy in a discussion about the patent licensing market. First, it is now difficult – perhaps impossible – for a patentee to give a party a sufficiently pointed notice of infringement to trigger the accrual of damages without *also* empowering the party to bring a declaratory judgment action against the patentee. Under the patent marking statute, damages do not accrue, where the patentee has not marked its own goods with the pertinent patent number, “except on proof that the infringer was notified of the infringement” – by letter or by lawsuit – “and continued to infringe thereafter,” 35 U.S.C. § 287(a). According to the Federal Circuit, “the actual notice requirement of § 287(a) is satisfied when the recipient is informed of the identity of the patent and the activity that is believed to be an infringement, accompanied by a proposal to abate the infringement, whether by license or otherwise.” *SRI International, Inc. v. Advanced Technology Labs.*, 127 F.3d 1462, 1470 (Fed. Cir. 1997). After *SanDisk*, such a letter undoubtedly enables its recipient to sue for a declaratory judgment. The cost of failing to mark is higher, and the patentee’s negotiating leverage absent marking is lower, as a direct result of *MedImmune* and *SanDisk*. This affects licensing strategy and royalty rates.

Second, *SanDisk* and its progeny enable a significantly wider group of potential infringers to bring their fight to the patentee by declaratory judgment. For example, Judge Bryson, writing separately in *SanDisk*, surmised that, “if there is any uncertainty” about

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<sup>1</sup> To like effect, see, e.g., *Sony Electronics, Inc. v. Guardian Media Technologies*, 497 F.3d 1271, 1285 (Fed. Cir. 2007) (upholding declaratory judgment jurisdiction in accused infringer Sony’s suit against patentee Guardian: “On the one side, Guardian communicated to Sony its position that certain identified Sony products infringed the ’158 and ’160 patents. . . . On the other side, Sony maintained that the asserted claims of the ’158 and ’160 patents were invalid in view of certain identified prior art references.”).

whether a patentee's communication signals adverse interests,

all the prospective licensee has to do in order to dispel any doubt is to inquire of the patentee whether the patentee believes its activities are within the scope of the patent. If the patentee says "no," it will have made a damaging admission that will make it very hard ever to litigate the issue, and thus will effectively end its licensing efforts. If it says "yes" or equivocates, it will have satisfied the court's test and will have set itself up for a declaratory judgment lawsuit.

*SanDisk*, 480 F.3d at 1384-85 (Bryson, J., concurring in the result). Importantly, even litigation against other, similarly-situated industry players can ground declaratory judgment jurisdiction, at least where a prior notice letter from the patentee links those players together with the declaratory judgment plaintiff. In *Micron Technology, Inc. v. Mosaid Technologies, Inc.*, 518 F.3d 897 (Fed. Cir. 2008), patentee Mosaid waged an enforcement campaign against the four leading DRAM chip makers – Samsung, Hynix, Infineon, and Micron. In June 2001, Mosaid "sent a warning letter strongly suggesting that Micron should license its technology." *Id.* at 899. After three more letters over the following year, Mosaid sued Samsung. Multiple suits and settlements later, in July 2005, Mosaid still had not sued Micron; "[p]ress reports," however, "predicted that Micron posed the obvious next target." *Id.* at 900. Micron sued Mosaid for a declaratory judgment of noninfringement of 14 Mosaid patents. Overturning the trial court's dismissal of Micron's suit, the Federal Circuit concluded that, despite Mosaid's more active focus on other purported infringers, Micron had a concrete dispute with Mosaid. *Id.* at 901-02. One key for the court, apart from Mosaid's warning letter in 2001, was Mosaid's "recent public statements and annual reports [that] confirm[ed] its intent to continue an aggressive litigation strategy." *Id.* at 901.

After *MedImmune*, a patentee can more easily take an assertive enforcement step that confers a declaratory judgment action option on a large circle of prospective licensees. Those licensees in doubt can provoke a sufficiently adverse statement quite readily, as Judge Bryson described in *SanDisk*. Patentees will thus find it harder to use a complex enforcement strategy that slowly rolls out against different prospective licensees, funding later enforcement with earlier successes. At the same time, potential licensees will find it easier to sue at a time and place of their own choosing, or to join ongoing litigation against a similarly situated putative infringer. The falling barrier to declaratory judgment attacks on a patent's validity highlights another issue – namely, how we should think about joint defense agreements among multiple accused infringers. I will offer some thoughts on that issue below, after canvassing likely license term responses to *MedImmune*.

## 2. License Terms After *MedImmune*

Licenses like the one at issue in *MedImmune* – which appeared to condition royalties on the patent's validity such that the licensee could adjudicate that validity, and which did *not* frame such a litigation challenge as a breach of the license – will be hard to renegotiate, although some patentees are doubtless trying. Going forward, patentees will almost certainly try to recapture the stability of the pre-*MedImmune* world, *i.e.*, "my licensee in good standing won't sue to attack my patent while paying royalties that prevent me from bringing an infringement action (with its attendant prayer for injunctive relief)." What license terms might patentees pursue?

A patentee's most direct expedient – securing a licensee's promise not to challenge the patent's validity or scope – is also the most questionable under existing case law. In the wake of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), the Supreme Court decision striking down

the state law doctrine of licensee estoppel, patentees sought to secure and enforce separate license terms in which licensees promised not to challenge the licensed patents. The lower courts, following a path the Supreme Court itself strongly foreshadowed in *Pope Mfg. v. Gormully*, 144 U.S. 224, 234-36 (1892), held such patent license terms unenforceable under *Lear*. See *Panther Pumps & Equip. Co. v. Hydrocraft, Inc.*, 468 F.2d 225, 231 & n.15 (7th Cir. 1972) (Stevens, J.); *Business Forms Finishing Serv. v. Carson*, 452 F.2d 70, 73-75 (7th Cir. 1971) (Stevens, J.); *Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co.*, 444 F.2d 425, 426-27 (9th Cir. 1971).<sup>2</sup> The Federal Circuit has not passed on the enforceability of “no challenge” clauses outside the context of a litigation settlement agreement or consent decree.<sup>3</sup> The *Pope* case is more than a century old.

Assume that a patentee cannot enforce a “no challenge” clause. How close to such a clause can a patentee get, functionally, by means of alternative license terms? If the courts conclude that *Lear* bars any license term that materially deters a licensee from challenging a patent, the answer is “not very.” If, instead, courts read *Lear* narrowly, many functional substitutes may survive. The post-*MedImmune* commentary suggests we will see license terms like the following<sup>4</sup> in the coming years:

- *Termination for Challenge* – If the licensee alleges that the patent is invalid, the patentee can terminate the license, giving the patentee the ability to pursue an infringement claim (including an injunction request)
- *Termination For Unsuccessful Challenge* – Same as above, except the patentee’s right to terminate comes after a licensee’s unsuccessful challenge
- *Royalty Increase for Challenge* – If the licensee alleges that the patent is invalid, the licensee is obliged to pay a higher royalty
- *Royalty Increase for Unsuccessful Challenge* – Same as above, except the patentee’s right to terminate comes after a licensee’s unsuccessful challenge
- *Licensee Pays Patentee’s Validity Litigation Costs* – If the licensee alleges the patent is invalid, the licensee must pay an amount that approximates the it will take to fund the patentee’s defense of the action
- *Unsuccessful Licensee Pays Patentee’s Litigation Costs and Fees* – Same as above, except the payment comes due after an unsuccessful challenge and could include attorney fees

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<sup>2</sup> More recently, two Courts of Appeals have refused to enforce “no challenge” clauses in the context of certification mark licenses. See *Idaho Potato Comm’n v. G&T Terminal Packaging*, 425 F.3d 708 (9th Cir. 2005); *Idaho Potato Comm’n v. M&M Produce Farm & Sales*, 335 F.3d 130 (2d Cir. 2003). Both decisions relied heavily on *Lear*.

<sup>3</sup> In the litigation settlement and consent decree contexts, the Federal Circuit has upheld “no challenge” clauses. See, e.g., *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362 (Fed. Cir. 2001); *Foster v. Hallco Mfg.*, 947 F.2d 469 (Fed. Cir. 1991).

<sup>4</sup> Two especially good pieces reward a close reading: John W. Schlicher, *Patent Licensing: What To Do After MedImmune v. Genentech*, 89 J. PAT. & TRADEMARK OFF. SOC’Y 364 (2007); Warren G. Lavey & Toshihiro Kuwahara, *Drafting Strategies for Licensing Agreements After MedImmune Decision*, in *ADVANCED LICENSING AGREEMENTS* (2008), Practising Law Institute # 14631. My list is adapted directly from these two excellent articles.

Assume that a patentee cannot enforce either a “no challenge” clause or a functional substitute for it. What might happen to patent license prices? Schlicher (note 4, *supra*) models the issue. An intuitive way to describe the matter, however, is this: If *MedImmune* can’t be neutralized, a patentee should price the license at a rate that will help the patentee pay to defend the patent against a declaratory judgment attack from the licensee (should such an attack come). The *stronger* the patentee believes the patent to be – and here, the fact that patent rights are probabilistic is quite important<sup>5</sup> – the *smaller* a litigation premium she needs to charge (because the litigation should be both less likely to happen, and easier to defend). Contrariwise, the *weaker* the patentee believes the patent to be, the *larger* a litigation premium she needs to charge. This larger premium, however, affects the very patents – weak ones – as to which prospective licensees will be less inclined to pay. After *MedImmune*, royalties for weak patents are harder to price at a level agreeable to both parties. Perhaps fewer will be licensed; perhaps more of them, in the short term, will wind up in litigation, in the form of patentee infringement complaints resolved with consent decrees containing enforceable “no challenge” clauses.

### 3. Analyzing Patent Infringement Joint Defense Agreements

As I noted above, more prospective licensees can now respond to patent assertions with credible declaratory judgment challenges. In general terms, cases such as *SanDisk* and *Micron* increase the likelihood that a patentee who asserts a patent against one or more parties will confront more putative infringers attacking the patent’s validity or scope, **IF** – and this is quite a big **IF** – the putative infringers can solve an appropriability problem they face. Specifically, as I have discussed in previous work,<sup>6</sup> the Supreme Court’s nonmutual collateral estoppel decision in *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 402 U.S. 313 (1971), makes it much harder for a successful patent attacker to recoup her investment in that successful attack: the invalidity judgment, once secured, benefits everyone, including the successful attacker’s competitors. We should thus expect patent validity challenges (and, to a lesser extent, patent scope challenges) to be undersupplied, absent a way for attackers with a common interest in defeating a patent to coordinate their efforts well enough to share the litigation costs.

This dynamic isn’t new, although *SanDisk* and its progeny may intensify putative infringers’ efforts to solve the appropriability problem just described. One stumbling block in their way is the conventional understanding in the patent law field that a robust joint defense agreement among accused infringers could be viewed as a group boycott and thus court antitrust liability. *See, e.g.*, Jeffrey T. Haley, *Strategies and Antitrust Limitations for Multiple Potential Patent Infringers*, 21 AIPLA Q.J. 327, 331-33 (1993). The key decision is *Jones Knitting Corp. v. Morgan*, 361 F.2d 451 (3d Cir. 1966), which condemned as an illicit group boycott the joint efforts of a group of declaratory judgment plaintiffs to invalidate a patent claim asserted by Morgan. If, as I suspect, more putative infringers will want to test the limits of their right to collaborate in challenging patents, *Jones Knitting* is due for some sustained scrutiny.

Let me offer some preliminary thoughts: The *Jones Knitting* group boycott analysis – even if relaxed to a rule-of-reason approach – misses a fundamental aspect of patents. Pat-

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<sup>5</sup> See Mark A. Lemley & Carl Shapiro, *Probabilistic Patents*, 19 J. ECON. PERSPECTIVES 75 (2005).

<sup>6</sup> Joseph Scott Miller, *Building a Better Bounty: Litigation-Stage Rewards for Defeating Patents*, 19 BERKELEY TECH. L.J. 667 (2004).

ent rights are probabilistic. And, from the beginning, our patent laws have included a large role for independent, vigorous court review of patent validity as a vital check on *ex parte* prosecution at the Patent Office. As a result, an analogy to group boycott cases involving commodities or other settled property rights (such as sugar beets for refiners,<sup>7</sup> or milk for cheesemakers<sup>8</sup>) is quite inapt. A patent right, once asserted, can face exhaustive court review.

A far better analogy to explore, I think, is that of an R&D joint venture.<sup>9</sup> Where a joint venture is designed to develop information the benefits of which are hard to appropriate, and which no one of the collaborating competitors would likely produce alone, the benefits are obvious. After the joint venture generates the information, the collaborators can use it independently in their competition with one another. Both innovation and competition interests are served. Apply this framework to patent litigation with multiple accused infringers who have a robust joint defense agreement: The fully litigated validity status of a patent claim is simply information. It is costly to generate, and – after *Blonder-Tongue* – its benefits are hard to appropriate. Surely it is worthwhile to consider whether we should give substantial antitrust leeway to accused infringers who work closely together to share the burdens of, and prevent premature settlements that frustrate, determining whether a patent claim asserted against their industry is, in fact, invalid or of materially narrower scope than the patentee contends. *Jones Knitting* appears to stifle procompetitive joint venture efforts in the patent litigation context, and new pressures may prompt its reappraisal.

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I am happy to assist the Commission in any way I can as it continues to explore the topic of this hearing.

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<sup>7</sup> *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U.S. 219 (1948).

<sup>8</sup> *Knevelbaard Dairies v. Kraft Foods, Inc.*, 232 F.3d 979 (9th Cir. 2000).

<sup>9</sup> Antitrust scholars routinely describe the basic justification for R&D joint ventures in terms of the ability of such ventures to overcome the free rider problem that generally undercuts the production of new information. See 13 HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 2115a, at 102-03 (1999) (explaining that one “rationale for joint innovation is lacunae in the legal protection of intellectual property”); Gene M. Grossman & Carl Shapiro, *Research Joint Ventures: An Antitrust Analysis*, 2 J.L. ECON. & ORG. 315, 321 (1986) (“A research joint venture may provide a means to solve the appropriability problem associated with the production of knowledge. Firms that will inevitably share in the benefits of any research discovery can agree *ex ante* to share in its costs. . . . In the extreme case, a joint venture form can facilitate the undertaking of socially profitable research projects that would otherwise not be pursued privately. In all cases, an RJV generates a social benefit whenever it allows a spillover externality to be internalized.”).