No. 05-608

IN THE

Supreme Court of the United States

MEDIMMUNE, INC.,
Petitioner,

v.

GENENTECH, INC., *et al.,*
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF RICHARD L. DONALDSON, ROBERT B. LIESEGANG, SR., AND EMMETT J. MURTHA AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

RICHARD A. EPSTEIN
1111 East 60th Street
Chicago, IL 60637
(773) 702-9563

JUSTIN A. NELSON
Counsel of Record
PARKER C. FOLSE, III
BROOKE A.M. TAYLOR
SUSMAN GODFREY L.L.P.
1201 Third Ave., Suite 3800
Seattle, WA 98101
(206) 516-3880

Counsel for Amici Curiae

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICI CURIAE*	1
INTRODUCTION AND SUMMARY OF ARGUMENT	1
ARGUMENT	3
I. THIS COURT SHOULD OVERRULE OR CLARIFY *LEAR V. ADKINS*, 395 U.S. 653 (1969), TO ENSURE THAT PRIVATE PARTIES CAN BARGAIN WITH CERTAINTY IN LICENSING AGREEMENTS	3
A. *Lear's* Rationale is Inconsistent With This Court's Later Decisions	3
B. Under This Court's "Pragmatic" Preemption analysis, *Lear's* Policy Judgment is Wrong	8
II. EVEN IF *LEAR* WERE ALLOWED TO STAND, ITS RATIONALE SHOULD NOT BE EXTENDED AS PROPOSED BY MEDIMMUNE	15
CONCLUSION	21

TABLE OF AUTHORITIES

CASES Page

Aetna Life Ins. Co. v. Haworth, 300 U.S. 227 (1937) 18
Aronson v. Quick Point Pencil Co., 440 U.S. 257 (1979) .... *passim*
Automatic Radio Mfg. Co. v. Hazeltine Research, Inc. 339 U.S. 827 (1950) 3
Bonito Boats v. Thunder Craft Boats, Inc., 489 U.S. 141 (1989) 8
Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234 (1964) 4, 5
D. H. Overmyer Co. v. Frick Co., 405 U.S. 174 (1972) 12
Goldstein v. California, 412 U.S. 546 (1973) 6
Illinois Tool Works v. Independent Ink, 126 S. Ct. 1281 (2006) 15
Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974) .... *passim*
Kinsman v. Parkhurst, 18 How. 289 (1856) 3
Lear v. Adkins, 395 U.S. 653 (1969) .... *passim*
In re Mahurkar Double Lumen Hemodialysis Catheter Patent Litigation, 831 F. Supp. 1354 (N.D. Ill. 1993) 11
Randall v. Sorrell, 126 S. Ct. 2479 (2006) 5
Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225 (1964) 4, 5, 8
Studiengesellschaft Kohle, M.B.H. v. Shell Oil Co., 112 F.3d 1561 (Fed. Cir. 1997) 16
United States v. Harvey Steel Co., 196 U.S. 310 (1905) 3

CONSTITUTIONAL AND STATUTORY PROVISIONS

35 U.S.C. § 271(d) 15
35 U.S.C. § 281 18

TABLE OF AUTHORITIES—Continued

Page

35 U.S.C. § 282 5
35 U.S.C. § 283 18
35 U.S.C. § 284 18
35 U.S.C. § 285 18
35 U.S.C. §§ 302-307 15
35 U.S.C. §§ 311-318 15

OTHER AUTHORITIES

Allison, John R., et al., *Valuable Patents*, 92 Geo. L. J. 435 (2004).. 17
American Intellectual Property Law Association Report of the Economic Survey 2003 (2003)..... 17
Brief for the United States as *Amicus Curiae*, *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) (No. 77-1413), 1978 WL 207171 ... 10, 19
Easterbrook, Frank H., *Contract and Copyright,* 42 Hous. L. Rev. 953 (2005) 12
Lemley, Mark A., *Rational Ignorance at the Patent Office,* 95 Nw. U. L. Rev. 1495 (2001).. 9, 17
Parchomovsky, Gideon & Wagner, R. Polk, *Patent Portfolios,* 154 U. Pa. L. Rev. 1 (2005) .. 9
Schlicher, John W., *A Lear v. Adkins Allegory*, 68 J. Pat. & Trademark Off. Soc'y 427 (1986) 11
Schlicher, John W., *Judicial Regulation of Patent Licensing, Litigation and Settlement Under Judicial Policies Created in* Lear v. Adkins*, in* 3 AIPLA Selected Legal Papers, No. 1 (1985).. 11, 19

INTEREST OF *AMICI CURIAE*

Amici are licensing experts with extensive experience in negotiating, drafting, and reviewing all types of licenses and deal structures, especially those regarding patents.[1] Richard L. Donaldson worked at Texas Instruments for 31 years and was senior vice president and general patent counsel when he retired in 2000. He had the primary role in developing and implementing Texas Instruments' world-wide licensing programs in the semiconductor, calculator, and computer industries. Robert B. Liesegang, Sr. spent 18 years at IBM working on patent licensing issues, including serving six years as Director of Patent Licensing for IBM's Asia Pacific region until he retired in 2000. Emmett J. Murtha was IBM's Director of Licensing from 1981 to 1993, and was Director of Business Development from 1993 to 1997. He was President of the Licensing Executives Society in the 1999-2000 term.

All *amici* believe strongly in the importance of certainty and predictability in patent licensing agreements.

INTRODUCTION AND SUMMARY OF ARGUMENT

The patent system is the primary way in which innovative ideas are translated into successful commercial inventions. That process of transformation starts with invention but in virtually all cases requires the use of licensing arrangements to complete it. The greater the success in licensing, the larger the return to individual patentees and the greater the spur to invention. Security of contract is essential to the successful use of all kinds of licensing arrangements.

This Court should affirm for two independent reasons. *First*, the Court should overrule or clarify *Lear v. Adkins*, 395

[1] No counsel for a party authored this brief in whole or in part, and no person other than *amici curiae* and their counsel has made a monetary contribution toward its preparation or submission. All parties have consented to the filing of this brief by letters filed with the clerk.

U.S. 653 (1969), and make clear that private parties have the ability to contract with certainty in the patent licensing context. *Lear* prevents certainty in licensing. *Lear* preempts state contract law by allowing licensees to terminate their contracts and then contest the validity of licensed patents based on the theory that these challenges further the "strong federal policy favoring free competition in ideas which do not merit patent protection." *Id.* at 656. This analysis, however, overlooks two fundamental goals of patent law that the Court has recognized in later cases such as *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974) and *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979): rewarding invention and encouraging disclosure. "Permitting inventors to make enforceable agreements licensing the use of their inventions in return for royalties provides an additional incentive to invention." *Aronson*, 440 U.S. at 262. *Lear* flies in the face of freedom of contract in commercial contexts.

Second, this Court should not adopt the rule proposed by MedImmune, which would extend the unsound rule in *Lear* by allowing a licensee to attack a patent without terminating the license. Under the rule in *Lear*, a licensee who wishes to attack the validity of the patent must first terminate the contract and forgo the benefit of the license. In other words, *Lear* requires the licensee to take a risk if it seeks to challenge a patent it has licensed. The licensee must either find some alternative invention to use in place of the patented technology or risk liability for patent infringement if it chooses to continue using that technology without a license. By allowing licensees simultaneously to pay the license royalty while attacking the license itself, the proposed rule would lead to a mushrooming of litigation and cause substantial unfairness to the licensor. Such a change also would harm most licensees by increasing royalty costs. The only licensees who will benefit are those such as MedImmune, who wish to undo their own voluntary bargains.

ARGUMENT

I. THIS COURT SHOULD OVERRULE OR CLARIFY *LEAR V. ADKINS*, 395 U.S. 653 (1969), TO ENSURE THAT PRIVATE PARTIES CAN BARGAIN WITH CERTAINTY IN LICENSING AGREEMENTS.

The procedural issues raised by Article III and the Declaratory Judgment Act offer this Court an easy way to affirm the decision below. Nevertheless, because of the enormous substantive importance of this issue, we urge this Court to use this case to ensure that private parties retain the maximum flexibility to structure their licensing transactions in the manner they deem best. The only way to achieve this end is to overrule or clarify *Lear v. Adkins*, 395 U.S. 653 (1969).

A. *Lear*'s Rationale is Inconsistent With This Court's Later Decisions

In *Lear*, this Court held that a licensee may terminate its license agreement at will in order to challenge the validity of the underlying patent. This ruling overturned the doctrine known as licensee estoppel, which had prevented a licensee from terminating a license agreement and thereby challenging the patent at issue in the contract. *See Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 836 (1950); *United States v. Harvey Steel Co.*, 196 U.S. 310, 316 (1905); *Kinsman v. Parkhurst*, 18 How. 289 (1856). Lear, the licensee, terminated the contract and stopped paying royalties to Adkins, the inventor, because Lear believed the patent was invalid. Adkins subsequently sued in California state court to enforce the contract, maintaining that Lear "was obliged to pay the agreed royalties regardless of the validity of the underlying patent." *Id.* at 656. The California Supreme Court ruled, as a matter of state contract law, that the doctrine of licensee estoppel applied and therefore barred licensees from terminating their licenses and challenging the validity of the underlying patents. *See id.* at 663; *see also id.* at 673.

This Court granted certiorari in *Lear* to reconsider the issue of licensee estoppel in light of two decisions that it had just issued—*Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964), and *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964). *Lear*, 395 U.S. at 656. In *Sears* and *Compco*, the Court ruled that the policies inherent in federal patent law preempted a state's unfair competition law that imposed liability for "the copying of an article which is protected by neither a federal patent nor a copyright." *Sears*, 376 U.S. at 225. In sweeping language, the Court held that "[t]o allow a State by use of its law of unfair competition to prevent the copying of an article which represents too slight an advance to be patented would be to permit the State to block off from the public something which federal law has said belongs to the public." *Id.* at 231-32. A contrary rule would allow States to give "perpetual protection to articles too lacking in novelty to merit any patent at all under federal constitutional standards. This would be too great an encroachment on the federal patent system to be tolerated." *Id.* at 232. In *Lear*, this Court considered whether the *Sears/ Compco* rationale of a "strong federal policy favoring free competition in ideas which do not merit patent protection," *Lear*, 395 U.S. at 656, meant that federal patent law impliedly preempted state contract law principles that prohibited patent licensees from challenging a patent's validity.

The Court in *Lear* held that "the federal law of patents" trumps "the common law of contracts." *Id.* at 668. It acknowledged that "[u]nder ordinary contract principles the mere fact that some benefit is received is enough to require enforcement of the contract, regardless of the validity of the underlying patent." *Id.* at 669. But in the Court's view, it was not "*unfair* to require a patentee to defend the Patent Office's judgment when his licensee places the question in issue." *Id.* at 670 (emphasis added). Indeed, even as the Court specifically acknowledged that licensee estoppel was "consistent with the letter of contractual doctrine," it refused to enforce the plain terms of a contract because it decided that licensee estoppel was not "compelled by the *spirit* of contract law." *Id.* (emphasis added). Instead, the Court ruled that the "important public interest in permitting full and free competition" outweighed the terms of the contract negotiated between the parties. *Id.* Thus, using only some free-form notion of "public interest" loosely divined either from the Constitution itself or implicitly from the patent laws, the Court preempted settled state contract law and the "technical requirements of contract doctrine." *Id.*

Lear was a dramatic extension of *Sears* and *Compco*. Unlike those cases, *Lear* did not concern an effort under state law that in effect would expand patentable subject matter beyond what Congress authorized. Instead, it affected patents issued by the Patent and Trademark Office that were presumptively valid under federal law. *See* 35 U.S.C. § 282. This distinction gives rise to a very different set of concerns from those discussed by the Court in *Sears*, *Compco*, and *Lear*. For while one goal of patent policy is to provide a means to challenge invalid patents, another goal is to ensure that inventors can effectively exploit valid patents and therefore reap the rewards of their innovations. This fundamental incentive to invent is seriously skewed if licenses are under constant siege, with no assurance of finality. Later cases have recognized this point explicitly, and made clear that this Court will not find preemption in the patent context without addressing *all* of the objectives of patent law. Indeed, "[s]ubsequent case law" has made *Lear* "a legal anomaly" and has "undermined its basic legal principles." *Randall v. Sorrell*, 126 S. Ct. 2479, 2489 (2006) (plurality opinion).

In *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974), the issue was "whether state trade secret protection is preempted by operation of the federal patent law." 416 U.S. at 472. The Court answered no: "The only limitation on the States is that in regulating the area of patents and copyrights they do not conflict with the operation of the laws in this area passed by Congress." *Id.* at 479. *See also Goldstein v. California*, 412 U.S. 546, 559 (1973) (refusing to find preemption of state law extending a copyright term). Unlike *Lear*, which found preemption of the common law of contracts based on "the strong federal policy favoring the full and free use of ideas in the public domain," 395 U.S. at 674, the Court in *Kewanee* noted two other primary objectives of patent law: "encouraging invention," and "disclosure, the quid pro quo of the right to exclude." 416 U.S. at 484.

The protection accorded to trade secrets by state law, the Court found, stimulated both invention and disclosure. Absent trade secret protection, the Court reasoned, "[t]he holder of a trade secret would not likely share his secret with a manufacturer who cannot be placed *under binding legal obligation* to pay a license fee or to protect the secret." *Id.* at 486 (emphasis added). "The result would be to hoard rather than disseminate knowledge." *Id.* Finally, the Court examined patent policy not only from the perspective of the holder of an invalid patent, as it did in *Lear*, but also from the perspective of patent owners who believe their inventions "meet the standards of patentability." *Id.* at 489. The *Kewanee* Court concluded by emphasizing the very features of patent law that should have led to the opposite result in *Lear*: efficiency in contracting, rewarding inventors, and congressional silence on the issue of preemption:

> Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it. Congress, by its silence over these many years, has seen the wisdom of allowing the States to enforce trade secret protection. Until Congress takes

> affirmative action to the contrary, States should be free to grant protection to trade secrets.

Id. at 493.

Five years later, in *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 258-59 (1979), the Court substantially undermined its stated rationale in *Lear* by holding that federal patent law does not preempt "state contract law so as to preclude enforcement of a contract to pay royalties to a patent applicant." The parties in *Aronson* negotiated a contract while the licensor's patent application was pending. The parties agreed that the licensee would pay a 5% royalty if the patent was granted and a 2.5% royalty if the patent application was not allowed within five years. *See id.* at 259. After the licensor failed to obtain a patent, the licensee attempted to renege on its contract. *See id.* at 260. It argued that federal patent law should preempt state contract law because the invention in *Aronson* was part of the public domain and *Lear* preempts those contracts that conflict with the "'the strong federal policy favoring the full and free use of ideas in the public domain.'" 440 U.S. at 261 (quoting *Lear*, 395 U.S. at 674).

This Court rejected the licensee's argument, and enforced the contract. The Court ruled that "[c]ommercial agreements traditionally are the domain of state law," *id.* at 262, and that "[o]ur holding in *Kewanee Oil Co.* puts to rest the contention that federal law pre-empts and renders unenforceable the contract made by these parties." *Id.* at 265. The Court examined all three goals of patent law it identified in *Kewanee*, not simply the single principle identified in *Lear* that ideas in the public domain should remain in the public domain. *See id.* at 262. The Court had little trouble finding that federal patent law did not preempt the contract because it judged the enforceability of the contract by focusing on the expectations of the parties at the time they made the agreement: "Permitting inventors to make enforceable agreements licensing the use of their inventions in return for royalties provides an additional incentive to invention." *Id.* Moreover, the Court emphasized the importance of the contract itself, noting that "the parties resolved the uncertainties by their bargain." *Id.* at 264. The *Aronson* court summarily distinguished *Lear*, concluding that "neither the holding nor the rationale of *Lear* controls when no patent has issued, and no ideas have been withdrawn from public use." *Id.* Yet the result and reasoning of *Aronson* are quite inconsistent with *Lear*.

In *Bonito Boats v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 154 (1989), the Court further undermined *Lear* by specifically disapproving the "absolutist" language of *Sears* and *Compco* that was the very reason why the Court reconsidered the issue of licensee estoppel and its interaction with federal patent law. *See Lear*, 395 U.S. at 656. Rejecting the proposition that *Sears* stands for "a broad pre-emptive principle," 489 U.S. at 154, the Court in *Bonito Boats* stated that "our decisions since *Sears* have taken a decidedly less rigid view of the scope of federal pre-emption under the patent laws." *Id.* at 156. *Kewanee* and *Aronson*, the Court explained, show a "pragmatic approach" in deciding "the pre-emption of state laws dealing with the protection of intellectual property." *Id.*

B. Under this Court's "Pragmatic" Preemption Analysis, *Lear*'s Policy Judgment Is Wrong

Lear overrode state laws of general applicability regarding the enforceability of contracts because of the Court's own judgment that federal patent law is inconsistent with finality and certainty in private licensing agreements. This assessment, however, is mistaken. A rule that enforces license agreements is in complete accord with federal patent policy and with this Court's preemption analysis. Rather, it is *Lear*'s broad rationale that is inconsistent with the "pragmatic" preemption approach adopted by this Court in post-*Lear* cases. *Bonito Boats*, 489 U.S. at 155.

Patent licensing agreements and exchanges today are of infinite variety. Patent owners may decide to license one patent for a set royalty rate. They might license a group of patents. They can agree to an exclusive or a non-exclusive license. They may decide to pool their patents, or engage in cross-licensing arrangements. They may donate their patents to a university, or commit to license a patent in order to join a standard-setting organization. Typically they use their patents as one part of a larger business transaction. *See generally* Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 Nw. U. L. Rev. 1495, 1500-08 (2001) (discussing some of the various ways patent owners use their patents). While the duration and price of the license are two standard terms, license agreements often contain literally dozens or even hundreds of clauses. "[T]he rise of patent portfolios in the business community has become so significant that portfolios have become the credo of firm value in the modern innovation environment." Gideon Parchomovsky & R. Polk Wagner, *Patent Portfolios*, 154 U. Pa. L. Rev. 1, 8-9 (2005). Licensing agreements are the critical mechanism by which parties exchange, share, and pool intellectual property rights. They mean little without certainty.

Lear does not further any of the goals of patent law that this Court identified in *Kewanee* and applied again in *Aronson*: encouraging invention, increasing disclosure, and allowing the public the full and free use of ideas in the public domain. *See Kewanee*, 416 U.S. at 484; *Aronson*, 440 U.S. at 262.

First, the *Lear* rule does not properly reward the inventor. As this Court stated in *Aronson*, "Permitting inventors to make enforceable agreements licensing the use of their inventions in return for royalties provides an additional incentive to invention." 440 U.S. at 262. The ability to bargain with certainty and create enforceable and predictable licensing agreements is central in properly incentivizing innovation.

The United States recognizes as much in its *amicus* brief on behalf of MedImmune, arguing that parties "may be able to" contract around any rule that increases uncertainty in licensing agreements, and identifying the means by which they may do so. Brief of United States as *Amicus Curiae* at 28. But the Government also acknowledges that the enforceability of the suggested provisions are "open question[s]" due to *Lear*. *Id.*

Moreover, the United States' alternatives are poor substitutes for a clear rule that would allow sophisticated parties to strike bargains in the manner they deem best. For example, the United States suggests that the parties could agree to a fully paid-up license in lieu of a contract specifying a reasonable royalty. Br. at 29. Such agreements, however, often are inefficient because they place an unquantifiable risk on one party or the other, frequently in a haphazard fashion. The patent holder who agrees to accept a lump-sum payment for a fully paid-up license runs the risk that the payment will prove to be inadequate if the licensor generates substantial revenues through exploitation of the patented invention. Similarly, the licensee risks paying a substantial sum of money for an invention that it might choose not to use or that may prove commercially unsuccessful. The government's suggestion of the up-front payment thus would compel parties to make inefficient agreements solely in an effort to work around unwanted public restraints on their freedom to contract as they see fit.

The United States itself made this very point in its *amicus* brief to this Court in support of the licensor in *Aronson*. *See* Brief for the United States as *Amicus Curiae*, *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) (No. 77-1413), 1978 WL 207171, at 8 ("At all events, a rule of law that would induce inventors to demand lump-sum payments, or payments spread over a short period, in order to be assured of adequate compensation for their ideas would not promote competition. It would simply require inventors and their licensees to guess about what the idea would be worth."); *see also id.* at 22-24 & n. 10. An agreement with an ongoing royalty rate allows both parties to contract around this uncertainty by tying price to use. *Cf. In re Mahurkar Double Lumen Hemodialysis Catheter Patent Litigation*, 831 F. Supp. 1354, 1397 (N.D. Ill. 1993) (Easterbrook, J.) ("The actual market beats judicial attempts to mimic the market every time."). Consequently, it is likely that rules permitting flexibility in negotiation and contracting will result in a greater degree of licensing activity than a rule practically requiring parties to agree on a lump-sum amount as a licensing condition.

By imposing its own policy judgment in place of those of the parties and of the States, *Lear* "dramatically limit[s] the value of a patent, interfere[s] with efficient utilization of inventions and lead[s] to major resource allocation losses." John W. Schlicher*, Judicial Regulation of Patent Licensing, Litigation and Settlement Under Judicial Policies Created in* Lear v. Adkins*, in* 3 AIPLA Selected Legal Papers, No. 1 (1985); *see also* John W. Schlicher, *A Lear v. Adkins Allegory*, 68 J. Pat. & Trademark Off. Soc'y 427 (1986). Left to their own devices in the negotiation process, the parties themselves will set the terms of the contract to reflect the relative strength of a patent, the likelihood of a finding of infringement, the potential scope of use of the invention, and a multitude of other factors relevant to their business objectives. Stated simply, if there is any question of the validity of the patent, it can reflect itself in the applicable royalty rate.

The parties should determine the terms of the contract, not this Court. If parties wish to make royalty payments contingent on a patent's validity, they can do so quite easily in the contract itself by specifying that the royalty rate will fall to zero should a court invalidate the patent. Or, as in this case, they can negotiate a license that covers patent applications as well as issued patents, with both sides recognizing, and contractually allocating, the risks and rewards in such a contract. Here, just that happened—MedImmune obtained advantageous license terms that include a small up-front payment, J.A. 402, a discounted royalty rate, *id*., a most favored nation clause, *id.* at 405, and a right to terminate the license, in whole or in part, on six month's notice, *id.* at 409. Thus, the actual history of this case shows the truth of the Court's earlier observation that the parties can "resolve[] the uncertainties by their bargain." *Aronson*, 440 U.S. at 264; *cf. D. H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 187-88 (1972) (enforcing the agreed terms of a contract despite waiver of Fourteenth Amendment due process rights in a cognovit note because the contract was negotiated between sophisticated parties). In short, "it is best to leave contract design to the market, where incentives are aligned rather than ignored. Everyone understands this for the branch of intellectual property that we call trade secrets. It is no less true of . . . patents." Frank H. Easterbrook, *Contract and Copyright*, 42 Hous. L. Rev. 953, 956 (2005).

Second, the *Lear* rule discourages people from applying for patents and therefore reduces disclosure of useful inventions. In direct contrast to *Lear*, *Aronson* guarantees certainty in licensing for *unpatented* inventions, even for those contracts negotiated during the pendency of a failed patent applications. "[P]atent-application licensing of this sort is desirable because it encourages patent applications, *promotes early disclosure*, and allows parties to structure their bargains efficiently." *Aronson*, 440 U.S. at 267 (Blackmun, J., concurring in the result) (emphasis added). The same is equally true for licenses dealing with those patent applications that have been approved by the PTO and have become patents.

Indeed, the divergence of *Aronson* and *Lear* leads to bizarre results that reward the unsuccessful patent applicant more than the owner of an issued patent. For example, in both *Lear* and *Aronson* (and indeed in the case at bar), the parties negotiated the licensing agreements before the patents issued. In *Lear*, this Court refused to enforce the parties' contract because the patent had issued and because the Court was persuaded that "[l]icensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery." 395 U.S. at 670. In *Aronson*, however, this Court *enforced* the agreement precisely because the patent application had failed. A rule that gives more rights to the failed patent applicant than to the patent owner would turn patent law on its head. In addition, it directly conflicts with *Aronson*'s analysis of determining preemption based on whether "enforcement of this agreement" would "discourage anyone from seeking a patent." 440 U.S. at 263. Rational inventors considering whether to seek a patent and ultimately disclose their work to the public could well decide that the significant uncertainty in their ability to enforce a patent means that it is better not to apply at all. Instead of disclosing their ideas in a patent application, they would choose to rely solely on trade secret protection and other state laws that offer fewer benefits than a patent but at least allow the inventor to license without fear of judicial intervention.

Third, even under the one patent principle identified in *Lear*—"the strong federal policy favoring the full and free use of ideas in the public domain," 395 U.S. at 674—the *Lear* rule is deficient. At the very least, this one goal is not strong enough of its own force to overcome the disincentives that the case imposes on innovation and disclosure. *Lear* permitted licensees to set aside the terms of their agreements under the rationale that "[l]icensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery." *Id.* at 670. But this rationale is incorrect on two grounds. First, large competitors of the patent owner also have enormous incentives to challenge a patent, and the patentee often is unwilling to negotiate with them precisely because it wishes to retain its competitive advantage. Second, it is far from clear why licensees are the only ones capable of challenging a patent. Patents are public, and the ability to discover prior art does not depend in any way, shape, or form on whether the investigator is in a contractual relationship with the patentee. With thousands of potential challengers in a market characterized by more and better information, the older rationale of *Lear* makes no sense today, if it ever did.

Clear licensing rules also facilitate another goal of patent law—the widespread dissemination of information. This objective is a close cousin both to the interest *Lear* identified, a strong federal policy in the free flow of ideas, as well to the fundamental federal interest in disclosure. Dissemination is vital to patent law because it allows the public to have access to the idea. The more a patent is licensed, the more likely it will be used, and the more likely it will spur even further innovation. Certainty promotes increased licensing of patented inventions. The *Lear* rule, by contrast, provides an incentive for patent owners to "hoard" information. *Kewanee*, 416 U.S. at 486. This solution often is sub-optimal for the patent owner and the public because licensing allows for the increased division of labor within the marketplace.

Lear's anti-license bias also adversely affects the public's access to patented ideas in other ways. Many potential licensees are firms seeking to use patented technology to enter new markets or enhance their competitive position in existing ones. Each new licensee may represent a new provider of a patented product. Clarity in licensing increases competition by allowing firms that have little prior experience to work together because they know they can rely on the contract itself to set the terms of the relationship even if the parties have no pre-existing ties. Conversely, a rule that imperils the predictability and enforceability of licensing arrangements would inhibit both cooperation and competition.

Finally, to whatever extent *Lear* was correct in 1969, it has been superseded by developments in Congress. Since 1980, Congress has permitted "[a]ny person at any time" to "file a request for reexamination" of a patent. 35 U.S.C. § 302. A re-examination may be *ex parte* or, since 1999, *inter partes*. *See* 35 U.S.C. §§ 302-307 (*ex parte* reexamination); 311-318 (*inter partes* reexamination). While a reexamination challenge is slightly more limited than a challenge to a patent in an Article III court, its availability nevertheless shows that Congress, not this Court, is in the best position to assess how to encourage challenges to a patent's validity and who should raise them.[2] Because any interpretation of *Lear*, let alone its broadest interpretation, does not further the aims of patent law as expressed by Congress or this Court, it should be overruled or modified to ensure that private parties retain the right to bargain for a patent license in the manner that best fits them.

II. EVEN IF *LEAR* WERE ALLOWED TO STAND, ITS RATIONALE SHOULD NOT BE EXTENDED AS PROPOSED BY MEDIMMUNE.

Lear was incorrect in holding that federal patent policy justified the preemption of state contract law despite ample evidence that the enforcement of license agreements works to achieve, not frustrate, the objectives of the patent system. Regardless of the soundness of the *Lear* rule, however, it does not extend to this case. Here, the licensee does not wish to terminate the agreement but instead wants to retain its own

---

[2] Moreover, Congress knows how to legislate in areas regarding the enforceability and propriety of patent licensing agreements. Since *Lear* was decided, Congress also has made clear through the patent misuse statute, 35 U.S.C. § 271(d), that it is not an abuse of the patent for a patent owner to tie different products and services together in a contract so long as the patentee does not have actual market power in the tying patent. *Cf. Illinois Tool Works v. Independent Ink*, 126 S. Ct. 1281, 1290-91 (2006).

benefit of the bargain (the negotiated royalty rate) while depriving the patent holder of the peace it thought it had negotiated through the license. In *Lear*, the Court "s[ought] to balance the claims of promisor and promisee *in accord with the requirements of good faith*." *Lear*, 395 U.S. at 670 (emphasis added). MedImmune's position is inconsistent with the requirements of good faith. Indeed, the types of challenges MedImmune wishes to facilitate do not occur on a regular basis now because of a good-faith belief on the part of both parties that the contract resolves their disputes. At the very least, this Court should not extend *Lear* to enable licensees to challenge patents without terminating their license agreement.

The easiest way to understand *Lear* is to treat it as though it granted the licensee an option to terminate an agreement at any time in order to challenge the validity of the patent. But that option comes with a price because a licensee who wishes to exercise it must abandon the protection furnished by the license and expose itself to serious risks of liability by continuing to use the invention, should the patent turn out to be valid. The unsoundness of the *Lear* rule is therefore mitigated by the reluctance of licensees to challenge their agreements and chance an adverse judgment.

Allowing licensees to avoid this risk would alter settled expectations and call into question the finality of all licenses. Since at least 1997, when the Federal Circuit decided *Studiengesellschaft Kohle, M.B.H. v. Shell Oil Co.*, 112 F.3d 1561 (Fed. Cir. 1997), both parties to a licensing agreement have assumed that a licensee is unable to challenge the licensed patent without first terminating the agreement. Changing such a rule would be a surprise gift to licensees, allowing them to keep the benefit of the agreed royalty rate and enjoy immunity from suit while granting them for no additional consideration the additional, unilateral option to challenge the patent and thereby possibly cancel their ongoing royalty obligations. Moreover, changing the rule could impose on licensors the burden of spending substantial sums in legal fees litigating an issue they thought had been finally resolved. *Cf. American Intellectual Property Law Association Report of the Economic Survey 2003*, at 22 (2003) (noting that the median litigation costs per side in a patent case are $500,000 when less than $1 million is at stake, $2 million when the dispute is between $1-$25 million, and at least $4 million per side when the amount is more than $25 million).

MedImmune's proposed rule also is an open invitation for endless litigation. Patent licenses often represent the settlement of litigation between the patent owner and an alleged infringer. Lemley, *supra*, at 1505 ("[L]itigation may be a useful settlement strategy, forcing the other side to the bargaining table. Indeed, that appears to be what litigation normally is, since the overwhelming majority of patent lawsuits settle, presumably with some form of licensing deal."). Licensing and litigation often go hand-in-hand. *See* John R. Allison et al., *Valuable Patents*, 92 Geo. L. J. 435, 439-40 (2004).

Under petitioner's proposed rule, however, the parties could never finally resolve a case because the licensee would retain the unwaivable right to challenge the license negotiated as part of the settlement agreement. Suppose, for example, that a defendant in a patent infringement lawsuit settles on the eve of trial by taking a license that calls for payment of an amount discounted from the damages the plaintiff sought at trial. Should that same defendant now be able to bring a declaratory judgment action challenging the validity of the patent, having locked in the royalty rate at the settlement price? A rule permitting such behavior would undermine business stability, discourage settlement, and decrease the incentives to file for a patent in the first instance, solely by raising the cost to patent holders of obtaining monetary rewards for their inventions.

Indeed, the incongruity of letting a licensee set aside a license negotiated as part of a settlement agreement shows why declaratory judgment actions are manifestly inappropriate whenever a license exists. The entire purpose of a settlement agreement is to bring cases to closure, which any subsequent litigation undoes. A contrary rule would force a patent owner to litigate through final judgment and appeal or face the risk that licensees will reignite the lawsuit at a time of their own choosing. A declaratory judgment action stemming from a license negotiated as part of a settlement makes no sense precisely because the settlement itself resolves the "controversy." *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240 (1937).

The rule is no more sensible in the context of license agreements negotiated without the filing of a suit: Taking a license resolves the controversy. Both pre-suit and post-suit, the patent holder has only one enforcement mechanism—a lawsuit to enforce the right to exclude under 35 U.S.C. § 281. That statute, entitled "Remedy for infringement of patent," states in full: "A patentee shall have remedy by civil action for infringement of his patent." A patent is not self-enforcing. It only grants the owner the right to bring a lawsuit and prove infringement of a valid and enforceable patent. A court awards injunctive relief, 35 U.S.C. § 283, damages, 35 U.S.C. § 284, or attorney fees, 35 U.S.C. § 285, only if a patent owner prevails in litigation. Whether the patent holder actually has filed suit often turns on the degree of success achieved in pre-suit negotiations. Yet treating licenses negotiated as part of a settlement in a different manner from licenses negotiated pre-suit would simply encourage patent holders to file a lawsuit before beginning any serious licensing discussions.

The most dramatic increase in litigation produced by MedImmune's rule, however, will come from licensees who will begin bringing declaratory judgment actions. If licensees can retain their licenses while challenging patents at the same time, it is a no-risk proposition for them but a source of substantial unfairness to licensors. For the licensee, bringing a lawsuit might well make economic sense whenever the litigation costs are less than the royalty obligation to the patent holder. Even by simply confronting the licensor with the burdens of litigation, a licensee may be able to induce a renegotiation of royalties, regardless of the merit of the licensee's invalidity contentions. These added costs will place a heavy burden on the holders of valid patents while giving licensees a free shot at challenging a patent. Under such circumstances, an overwhelming increase in litigation is predictable.

Ultimately, the proposed rule will adversely affect not just licensors, but many licensees as well. All licensees will pay more as patent owners increase the cost of a license—particularly through higher up-front payments—in order to factor in the additional inconvenience, expense, and risk of enhanced litigation exposure. Such a rule will particularly disadvantage those licensees who are quite content to respect the patent terms in full. They, too, will face enhanced royalty costs because they cannot offer any binding legal assurance to the licensor of their willingness to adhere to the negotiated agreement. *Cf.* Schlicher, *A Lear v. Adkins Allegory*, 68 J. Pat. & Trademark Off. Soc'y at 433; Br. of United States as *Amicus Curiae*, *Aronson v. Quick Point Pencil*, at 23 n. 11. MedImmune's proposed rule will benefit only those licensees who, *ex post*, want to escape from the terms of their contract.

* * * * *

If this Court holds that neither Article III nor the Declaratory Judgment Act prohibits these types of challenges, it is even more important that the Court also make clear that

Lear does not pose an obstacle for parties who want to bargain for certainty in licensing agreements. *Cf.* Brief of *Amicus Curiae* Licensing Executives Society in Support of Neither Party (arguing that the Court should use this opportunity to clarify the scope of *Lear*). The Court should allow private parties to negotiate clauses such as "no-contest" provisions that would prevent a licensee from challenging the patent, or other clauses that would help achieve finality in the resolution of disputes. At the very least, the Court should not go beyond *Lear*, and should require licensees to terminate their licenses before bringing suit. Sophisticated parties should be able to make such agreements without fear that their contract will be preempted.

As licensing specialists we see no reason to further undermine the operation of the patent system by making it easier for parties to abrogate contracts that reflected their joint intention when formed. It seems almost grotesque to hold that federal patent law preempts the very features of state contract law that help enhance the value of the patent system. Regardless of whether this Court decides to modify the *Lear* rule itself, it should reject MedImmune's attempt to produce an unwarranted extension of that unsound principle. The Court should avoid the serious dislocation to the patent system that will surely follow from such a result.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully Submitted,

RICHARD A. EPSTEIN
1111 East 60th Street
Chicago, IL 60637
(773) 702-9563

JUSTIN A. NELSON
Counsel of Record
PARKER C. FOLSE, III
BROOKE A.M. TAYLOR
SUSMAN GODFREY L.L.P.
1201 Third Ave., Suite 3800
Seattle, WA 98101
(206) 516-3880

Counsel for Amici Curiae

July 26, 2006