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Justices lower bar to patent challenges

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WASHINGTON — Companies that agree to pay royalties to a patent holder can nevertheless challenge the patent's validity while still bound by the licensing contract, The Supreme Court ruled Tuesday.

In their 8-1 decision, the justices rejected arguments that a licensee waives its right to question a patent once it agrees to pay royalties to the holder, or patentee. A licensee can reasonably choose to pay the fee — thus avoiding the risk of being ordered to pay triple damages for breaching a royalties contract — without forfeiting its right to challenge the underlying patent, the court said.

Chicago patent attorney Joseph E. Shipley hailed the court's decision for enabling licensees to challenge patents without first having to break their licensing agreements. Such freedom is important to combat the growing presence of "patent trolls," said Shipley, vice president of the Intellectual Property Law Association of Chicago.

The term refers to people who do not invent but simply buy patents so they can receive royalty payments from the licensees who actually make use of the inventions.

"It [the decision] sort of levels the playing field" between licensees and trolls, said Shipley, a partner at Fitch, Even, Tabin & Flannery. Shipley, who represents both patent holders and licensees, said he regrets that Genentech Inc., a respected biomedical company and certainly not a troll, was the losing patentee in the case.

Justice Antonin Scalia, writing for the majority, said licensees are similar to citizens who challenge the constitutionality of a law that criminalizes the distribution of handbills.

A citizen who complies with the law to avoid prosecution nevertheless retains the right to challenge the statute's constitutionality, Scalia wrote. Likewise, a licensee who complies with the terms of a royalty contract to avoid liability for breach can still challenge the patent's validity, he stated.

Both the citizen and the challenger can comply "under protest," he said, while retaining their rights to challenge, Scalia wrote in *MedImmune Inc. v. Genentech Inc.*, No. 05-608.

But Justice Clarence Thomas, who cast the court's sole dissenting vote, said no parallel exists between a citizen and a licensee.

A citizen has little say in the enactment of a criminal law and has essentially no choice but to comply, lest he or she be jailed or fined, Thomas wrote. A licensee, by contrast, voluntarily enters into the contract, thereby tacitly acknowledging the validity of the underlying patent, he added.

A licensee who wants to challenge the patent should not be able to do so while under contract, Thomas stated. He or she must either decline to sign the accord or breach the agreement before raising the objection, he added.

The court's decision permits MedImmune to proceed with its lawsuit challenging the validity of Genentech's patent on cell-alteration technology while continuing to pay royalties under a licensing agreement. The U.S. Court of Appeals for the Federal Circuit had agreed with a lower court that dismissed the lawsuit.

The Federal Circuit said MedImmune's continued payment was its acknowledgment that Genentech's patent was valid. Thus no "case or controversy" existed with regard to the patent and MedImmune had no standing to sue, as required under Article III of the Constitution, the Federal Circuit ruled.

MedImmune then persuaded the Supreme Court to hear its appeal.

Genentech had urged the high court in vain to uphold the Federal Circuit, saying it would be unfair to allow MedImmune to challenge the patent's validity while the company, by making its royalty payments, prevented Genentech from countersuing it for infringement. The high court rejected this argument, ruling that a licensing agreement is only a promise to pay royalties and not an acceptance of the underlying patent's validity.

A prohibition on mounting a challenge "can hardly be implied from the mere promise to pay royalties on patents which have neither expired nor been held invalid by a court or other body of competent jurisdiction from which no appeal has been or may be taken," Scalia wrote. "Promising to pay royalties on patents that have not been held invalid does not amount to a promise not to seek a holding of their invalidity."

Had MedImmune stopped making its royalty payments before challenging the patent's validity, the company could have been ordered not only to pay triple damages for breaching the contract but to stop selling its licensed

product, Synagis, which fights a respiratory ailment in some infants and has accounted for more than 80 percent of the company's sales revenue since 1999, Scalia said.

Licensees should not be required to leave themselves open to crippling liability and to "bet the farm" in order to challenge a patent's validity, Scalia said.

Thomas, in dissent, said that a company acknowledges a patent's validity when it agrees to a licensing agreement, thus forfeiting its right to sue for infringement. The agreement, once signed, eliminates any controversy regarding the patent's validity, he added in criticizing the court's ruling.

"By holding that contractual obligations are sufficiently coercive to allow a party [to challenge a patent], the majority has given every patent licensee a cause of action and a free pass around Article III's [case or controversy] requirements for challenging the validity of licensed patents," Thomas said.

MedImmune and Genentech are both in the high-tech field of manipulating human cells to produce antibodies to combat disease. In 1989, South San Francisco, Calif.-based Genentech received a patent on its version of the technology, which the company uses to combat breast and colorectal cancer.

Genentech co-owns the patent with City of Hope, a nonprofit biomedical research institution in Duarte, Calif., that is also a party to the Supreme Court litigation.

Meanwhile, Gaithersburg, Md.-based MedImmune developed similar technology to combat respiratory syncytial virus, a contagious viral condition that can be fatal to infants with heart or lung ailments. Genentech told MedImmune that its technology potentially infringed Genentech's patent, spurring MedImmune to sign the licensing agreement in 1997.

In signing the agreement with Genentech, MedImmune said it made clear that it was not waiving its right to later challenge the validity of Genentech's patent. MedImmune, while still making payments under the agreement, mounted its challenge on April 11, 2003, suing Genentech in the U.S. District Court for Central California.

The court dismissed the suit, saying that MedImmune had no standing to challenge the patent because by paying the licensing fee the company was acknowledging the patent's validity. The Federal Circuit agreed.