

License and Settlement Agreements in Relation to Reexamination and Review Proceedings

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Passage of the Patent Reform Act of 2011 (a.k.a. the Leahy-Smith America Invents Act) transforms the landscape for validity challenges. The new landscape includes *ex parte* reexamination, *inter partes* reexamination (until phased out), post-grant review and *inter partes* review, which will replace *inter partes* reexamination. This article discusses considerations for license and settlement agreements in relation to these proceedings.

LICENSING PRIOR TO LITIGATION OR POST-GRANT PROCEEDINGS

Under the so-called *Lear* doctrine, which the Supreme Court originated in *Lear, Inc. v. Adkins*,¹ a patent licensee can challenge the validity of the licensed patent. A licensor seeking to draft around the *Lear* doctrine can utilize various contractual solutions,² as summarized below:

- a. Notice clause: requires that a licensee provide, within a specific time period, the licensor with copies of prior art that will be used to challenge the validity of the patent;
- b. Forum-selection clause: limits a challenge to a particular dis-

trict court, the ITC, or the Patent Office;

- c. Royalty-escalation clause: upwardly adjusts the royalty rate during a challenge and/or if the licensee fails in a challenge attempt;
- d. Fee-shifting clause: requires a licensee to pay the licensor's legal fees and costs for defending against a challenge, on an ongoing basis or as a large lump-sum payment;
- e. Termination-on-challenge clause: permits the licensor to terminate the contract if the licensee challenges the patent; and
- f. No-challenge clause and limited-challenge clause: either bars or selectively bars validity challenges in litigation, reexamination and/or review proceedings.

These provisions are discussed below in relation to validity challenges at the Patent Office.

Notice Clause in License Agreements

A notice clause provides the licensor with an opportunity to file a request for *ex parte* reexamination or to file a reissue application to correct the patent based on the prior art references revealed in accordance thereto. Such a filing may enable the patent owner to stay a declaratory judgment action subsequently filed by the licensee.³ Such patent review without interaction from the licensee also often occurs in other contexts, such as when a party that has been contacted or sued by a patentee provides information to the patent owner regarding a validity analysis of or flaws in the patent. To prevent the patentee from attempting to correct the patent, a party may merely allude to the existence of a damaging prior art reference, and may move forward with litigation while pursuing simultaneous

reexamination proceedings at the Patent Office.

To safeguard against being shut out of a validity challenge at the Patent Office by divulging damaging information, such as a prior art reference identified in a validity search, a draft request for reexamination or a review proceeding (known as a "pocket" request), a licensee may consider sharing the information only if the patent owner is willing to reach an agreement regarding the manner in which the information is used. For example, the parties could agree that the information can only be used in an *inter partes* proceeding at the Patent Office so that both parties can participate while the patent owner maintains the right to amend the claims. Negotiating the terms of the notice clause in this manner may only be acceptable to a patent owner where the patent is relatively untested.

Alternatively, the parties could agree that the patent owner cannot file its own request for reexamination or reissue application based in whole or in part on the disclosed information for a set period of time. The parties could further agree to a trigger for full release for past infringement and a royalty-free license going forward if the patent owner files a reexamination request or reissue application before expiration of the set time period. In return, the patent owner could require that the information not be used in a declaratory judgment action during the set time period, which would permit the patent owner to attempt to maintain some value in the patent via the *ex parte* reexamination request or reissue application that it has filed, in which the licensee cannot participate.

Forum-Selection Clause in License Agreements

Licensors and licensees that include a forum clause often use it to limit the challenges to a particular district court to obtain a geographic advantage or to ensure the venue is with a court that has a particular track record for speed or upholding patents. However, consideration should also be given to the vehicles at the Patent Office for challenging validity under the Patent Reform Act, and attempts should be made to determine which available forum may be preferable. Because post-grant review proceedings provide for validity challenges on any basis permitted in litigation, such additional forum considerations include the expected lower costs and greater speed of post-grant review proceedings, versus the

more limited discovery opportunities in these proceedings. After expiry of the nine-month period in which post-grant review proceedings can be pursued, the forum options may depend on the basis for the challenge. Reexamination and *inter partes* review can only be based on printed prior art publications, so a forum-selection clause could require challenges to be brought at the Patent Office using one of these vehicles while permitting other challenges to be pursued via litigation. This dual approach was recently analyzed in detail and recommended with respect to forum-selection clauses that require the use of *inter partes* reexamination as the vehicle for challenging validity.⁴

Royalty-Escalation and Fee-Shifting Clauses in License Agreements

Royalty-escalation and fee-shifting clauses can be used to incentivize the licensee not to challenge the validity of the patent. They can also be used to discourage one type of challenge relative to another. For example, it may be preferable to discourage litigation relative to a proceeding at the Patent Office so that the claims can be modified. This can be done by including a fee-shifting clause only for litigation, or by providing for a higher royalty rate if a claim survives litigation rather than a proceeding at the Patent Office.

Termination-on-Challenge Clause in License Agreements

A termination-on-challenge clause prevents a licensee from enjoying the advantages of a patent while simultaneously seeking to invalidate it. The clause enables the licensee to challenge the patent in any venue(s) (absent a forum-selection clause). The patent owner gains the opportunity to receive damages that are possibly more significant than the amount provided by the royalty, as well as the possibility of treble damages for willful infringement.⁵ Because enforceability of such provisions is not yet settled,⁶ those who promote inclusion of such clauses also caution that a severability clause is needed so that the other clauses in the agreement can be relied on if the termination-on-challenge clause is held to be not enforceable under the *Lear* doctrine.

No-Challenge Clause and Limited-Challenge Clause in License Agreements

This article does not analyze the view that no-challenge clauses are unenforceable under the *Lear* doctrine, as the topic has been thoroughly analyzed in many

sources. However, it is acknowledged that some commentators advocate inclusion, along with a severability clause, of a no-challenge clause⁷ or at least a limited-challenge clause that permits a challenge only when defending a suit for royalties or patent infringement.⁸

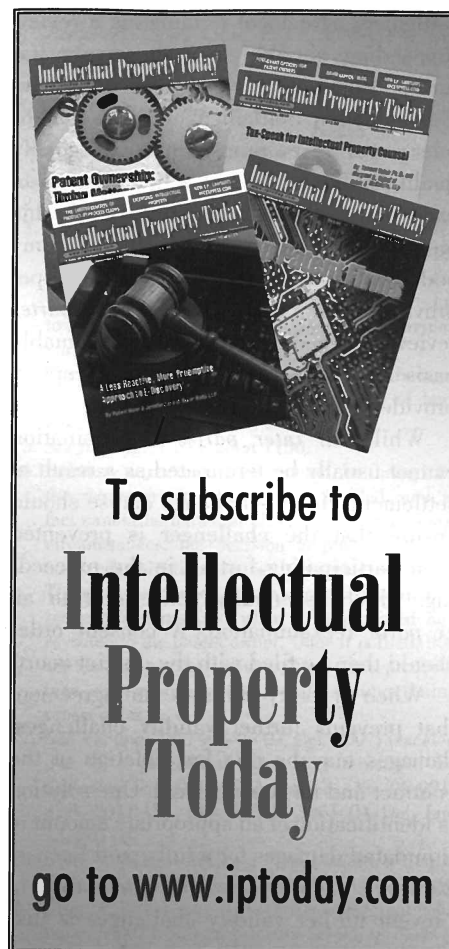
SETTLEMENT AGREEMENTS FOLLOWING LITIGATION OR POST-GRANT PROCEEDING

The *Lear* doctrine does not apply to settlement agreements⁹ and consent judgments¹⁰ for policy reasons related to judicial efficiency. So termination-on-challenge clauses, no-challenge clauses and limited-challenge clauses are enforceable for settlement agreements and consent judgments. All of the other clauses discussed above with respect to license agreements should be considered and tailored with respect to settlement agreements and consent judgments. For example, in a settlement agreement or consent judgment, the notice clause should be accompanied by a representation and warranty that the licensee has disclosed to the patent owner all prior art references known to be relevant to the validity of the licensed patent.¹¹

As illustrated by several cases that are profiled below, a settlement agreement provides clearer options than a license agreement, and a consent judgment provides a patent owner with more robust options than a settlement agreement. On this basis, some commentators have emphasized that that it is preferable to initiate litigation prior to license negotiation to benefit from these distinctions.¹²

No-Challenge Clause in Settlement Agreements

Settlement agreements should include a clause that generically prevents any further challenges to the validity of the patent in any manner whatsoever, whether in litigation at a district court, in an ITC proceeding or via any available vehicle that currently exists or may ever exist at the Patent Office, including reexamination and review proceedings. The need for such omnibus language was highlighted in *Joy Manufacturing Co. v. National Mine Service Corp.*,¹³ which involved a settlement agreement that prevented the defendant from filing “any suit in any United States Court or any Court in any foreign country challenging or contesting the validity of the patent.” The settlement agreement was reached several years after the creation of the system



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for *ex parte* reexamination.¹⁴ The agreement was not incorporated into the court’s judgment, which was simply a dismissal of the complaint without prejudice. The defendant filed a request for *ex parte* reexamination, which was the only vehicle at the time for challenging validity at the Patent Office. The plaintiff then filed a motion in the district court to enforce the settlement agreement. The court denied the motion, and the Federal Circuit affirmed, stating that a request for reexamination is not equivalent to a court suit challenging the validity of the patent. The Federal Circuit concluded with the following words of caution: “In view of the new reexamination procedure, parties would be well advised to draft agreements, where appropriate, to encompass this new facet of patent law.”¹⁵ Of course, the same is true for the new regime of post-grant and *inter partes* review proceedings.

In contrast to *ex parte* and *inter partes* reexamination, it will be possible to terminate post-grant and *inter partes* review proceedings through settlement.¹⁶ The settlement will not result in any estoppel implications for the party that petitioned for the review proceeding. Just like the lesson learned from *Joy Manufacturing*, a

settlement agreement terminating a review proceeding should comprehensively bar further litigation, review proceedings and reexamination. Settlement of a post-grant or *inter partes* review proceeding also arguably qualifies, like settlement of litigation, as an exception to the *Lear* doctrine. While this topic merits further analysis, the economy and finality resulting from the estoppel provisions for post-grant and *inter partes* review proceedings provide an arguable basis for extrapolating from the exception provided for settlement of litigation.

While an *inter partes* reexamination cannot usually be terminated as a result of settlement, the no-challenge clause should ensure that the challenger is prevented from participating further in the proceeding, which essentially converts it to an *ex parte* reexamination. A consent order should then be filed with the district court.

When a party violates an agreement that prevents further validity challenges, damages may be due for violation of the contract and for infringement. One solution is identification of an appropriate amount of liquidated damages for a fully paid license. However, a problem with attempting to prevent further validity challenges is that reexamination can be requested anonymously by a third party. Such a violation of a covenant not to file a request for reexamination may be difficult to address.

Forum-Selection Clause in Settlement Agreements

In *Callaway Golf Co. v. Acushnet Co.*,¹⁷ a settlement agreement expressly provided that “[a]ny dispute arising out of or relating to patents” must be resolved by the procedures set forth therein, which are “the sole and exclusive procedure[s] for the resolution of any such dispute.” The procedures included mediation and litigation in the Delaware district court. Despite this clause, Acushnet filed requests for *inter partes* reexamination to challenge several of Callaway’s patents directed to multi-layer golf balls.

The forum-selection clause, which was referred to as a dispute resolution clause, did not block validity challenges; it just restricted them to a particular forum. The agreement was signed in 1996, three years before the creation of the system for *inter partes* reexamination. However, because the agreement excluded any other “proceedings” not initiated in the Delaware district court, it was viewed as guarding against a change in the law. The clause was

interpreted as a forum-selection clause that merely restricts where validity can be challenged. The court concluded that Acushnet had violated the agreement.

As noted above, the agreement in *Joy Manufacturing* was written when the system for *ex parte* reexamination was quite new, and the agreement in *Callaway* was written before the system for *inter partes* reexamination was created. However, their outcomes were different because the agreement in *Callaway* provided for an exclusive forum. Of course, a forum-selection clause is needed to identify a forum for resolving disputes for issues other than invalidity challenges, such as whether a particular product falls within the scope of a licensed patent; however, it would be best to also include an omnibus no-challenge clause.

Instead of seeking an injunction at the outset of the reexamination to block Acushnet’s participation in the *inter partes* reexamination based on the settlement agreement, Callaway attempted to assert its rights at the Patent Office.¹⁸ However, Acushnet’s efforts failed because the Patent Office has a statutory mandate to reexamine patents when faced with a reexamination request that meets the statutory requirements. Callaway also failed to block the reexaminations by suing the Patent Office.¹⁹ It has been speculated that if the contract issue is decided by the Federal Circuit and the claims from the reexamination are considered unpatentable, then the patents may be considered void *ab initio*.²⁰ The next case detailed below involved an agreement wherein the patent was considered not void *ab initio* but as becoming void only when it ceased to have legal force.

Precision Regarding Applicable Version of Claims and Lifespan of Patent Needed in Settlement Agreements

In *Panduit Corp. v. HellermannTyton Corp.*,²¹ a settlement agreement was in dispute from a prior patent infringement lawsuit, which prevented HellermannTyton from making and selling any “item covered by any claim of the Panduit Patent.” Panduit brought an additional suit against HellermannTyton alleging further infringement of its patent. While this additional suit was ongoing, the Patent Office began a reexamination of Panduit’s patent. HellermannTyton successfully obtained a stay of the infringement portion of the suit. However, the court denied repeated motions by HellermannTyton to stay Panduit’s breach of contract claim. According to the

court, the agreement was not contingent on whether the claims of the patent were valid; so long as an item was covered by a claim of the patent, its manufacture and sale was prohibited. Accordingly, it would be “irrelevant” whether the patent were modified in the reexamination.²²

The court also interpreted the phrase “life of the patent,” which was used in the agreement to demarcate its term. Panduit asserted that this phrase meant the “natural life” of the patent, regardless of whether it were to meet an early demise in the reexamination. Conversely, HellermannTyton contended the phrase could retroactively nullify the agreement if the patent were found invalid. The court took a view that it characterized as a “middle-ground” approach in which the agreement extended from the grant date of the patent to the date on which it ceased to have legal force.²³

Panduit highlights the importance of ensuring that agreements provide for the possibility that the claims of a patent may be altered or invalidated through reexamination or some other post-grant proceeding. Had HellermannTyton insisted on language such as “covered by any valid, enforceable claim of Panduit’s patent in its present form,” a stay likely would have been granted. Additionally, agreements should avoid all ambiguities regarding their temporal scope. A malleable term such as “the life of the patent” should be replaced with an exact definition of the period over which the claims are in force, along with provisions that address the possibility of the claims being found invalid through some post-grant vehicle.

CONSENT JUDGMENTS

Consent judgments have the force of *res judicata* to protect the parties from future litigation and may be enforced by judicial sanctions including a citation for contempt. However, the agreement between the parties is not equivalent to a judicial decision on the merits because the agreement embodies primarily the results of negotiation rather than adjudication.

Contempt of Consent Judgment

In *Houston Atlas, Inc. v. Del Mar Scientific, Inc.*,²⁴ the parties executed a settlement agreement, and a consent judgment was entered wherein the defendant acknowledged validity of certain claims of the patent. After the creation of the reexamination system, the defendant filed a request for reexamination. The plain-


tiff filed an application for a temporary restraining order against the Patent Office that was denied because the Patent Office was not in privity with the defendant. The plaintiff also filed a motion to hold the defendant in contempt, which was granted along with fees and costs. The court reasoned that any other outcome would render the consent judgment meaningless. The plaintiff was ordered to withdraw his request for reexamination even though it was recognized that the Patent Office would likely ignore the attempted withdrawal and the reexamination would continue.

Modification of Consent Judgment

In *Glasstech, Inc. v. As Kyro Oy*,²⁵ litigation was settled by a consent judgment, and the plaintiff's patent was subsequently subjected to reexamination. After the claims were rejected and were in condition for appeal, the defendant began making payments due under the consent judgment to an escrow agent and then sought relief under Fed. R. Civ. P. 60(b) for modification of the judgment. The motion to modify the consent judgment was denied. It was noted that the consent judgment had failed to address what the effect would be if the patent were finally rejected as result of reexamination. The situation was distinguished from *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348, 350 (Fed. Cir. 1988), which involved a settlement order requiring royalty payments even if the patent were later held invalid in another proceeding. So presumably, the court would not have required continued payment if the defendant sought relief from the consent judgment after the completion of the reexamination.

CONCLUSION

There are many options for discouraging validity challenges in license agreements and further challenges in settlement agreements. In light of the new vehicles for challenging validity at the Patent Office, these options need to be considered when drafting agreements. There are complications for enforcing some clauses in license and settlement agreements that are simplified when there is a consent judgment.

The Patent Office is statutorily required to behave as a juggernaut without regard to contractual obligations. When attempting to enforce a contract, the actions of the party in violation of the agreement should be targeted instead of seeking a solution from the Patent Office. 

ENDNOTES

- 395 U.S. 653 (1969).
- Ron A. Bleeker & Michael V. O'Shaughnessy, *One Year After MedImmune – The Impact on Patent Licensing & Negotiation*, 17 Fed. Cir. B.J. 401 (2008); John W. Schlicher, *Patent Licensing, What to Do After MedImmune v. Genentech*, 89 J. Pat. Off. Soc'y 364, 382-92 (2007); Catherine Nyarady, *MedImmune v. Genentech: Unanswered Questions*, 237 N.Y. L.J. 22 (2007); Stephanie Chu, *Operation Restoration: How Can Patent Holders Protect Themselves from MedImmune?*, 2007 Duke L. & Tech. Rev. 8, 10-22; Paul F. Prestia, *The Supreme Court Puts Patent Royalties in Play*, *The Legal Intelligencer* (2007).
- Bleeker & O'Shaughnessy, *supra*, 17 Fed. Cir. B.J. 401.
- Dmitry Karshedt, *Contracting for a Return to the USPTO: Inter Parties Reexaminations as the Exclusive Outlet for Licensee Challenges to Patent Validity*, 51 IDEA 309 (2011).
- Michael Risch, *Patent Challenges and Royalty Inflation*, 85 *Ind. L.J.* 1003-57 (2010).
- Id.* at 1031. *But see* Nyarady, *supra*, 237 N.Y. L.J. 22 (contending that the Federal Circuit has implicitly recognized the validity of a termination-on-challenge clause).
- Schlicher, *supra*, at 382-92.
- Nyarady, *supra*, 237 N.Y. L.J. 22.
- Hemstreet v. Spiegel, Inc.*, 851 F.2d 348 (Fed. Cir. 1988); *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362 (Fed. Cir. 2001).
- Foster v. Hallico Mfg. Co.*, 947 F.2d 469 (Fed. Cir. 1991); *Diversey Lever, Inc. v. Ecolab, Inc.*, 191 F.3d 1350 (Fed. Cir. 1999).
- Prestia, *supra*.
- Risch, *supra*, at 1003-57.
- 810 F.2d 1127 (Fed. Cir. 1987); *see also WHY ASAP, LLC v. Compact Power*, 461 F. Supp. 2d 308, 314-15 (D.N.J. 2006) (noting that a validity argument that could not be pursued in court due to a covenant not to sue could instead be pursued via reexamination).
- The system for *ex parte* reexamination became available on July 1, 1981, as a result of laws enacted on December 12, 1980.
- See Joy Mfg.*, 810 F.2d at 1130.
- Because a reexamination cannot be halted by the requester after the request is filed, and in fact cannot be halted at all except in exceptional circumstances, the decision to pull the trigger on a reexamination request is a serious decision. The settlement leverage of a strong reexamination request is maximized when it is prepared and revealed to the patent owner. Once it is filed, that settlement leverage vanishes. For review proceedings, settlement negotiations will continue during prosecution.
- 523 F. Supp. 388, 405-06 (D. Del. 2007) (vacated due to a procedural error, but reinstated by *Callaway Golf Co. v. Acushnet Co.*, No. 06-091-SLR, 2011 U.S. Dist. LEXIS 3361 (D. Del. Jan. 13, 2011)).
- Scott A. McKeown, *Can a Forum Selection Clause Prevent Patent Reexamination?*, Patents Post-Grant (Aug. 1, 2011), <http://www.patentspostgrant.com/lang/en/2011/08/can-a-forum-selection-clause-halt-patent-reexamination>.
- Callaway Golf Co. v. Acushnet Co.*, No. 1:11CV266, 2011 U.S. Dist. LEXIS 82381 (E.D. Va. July 27, 2011).
- Scott A. McKeown, *Callaway Golf's Last Stand in Patent Reexamination*, Patents Post-Grant (Jan. 20, 2011), <http://www.patentspostgrant.com/lang/en/2011/01/callaway-golfs-last-stand-in-patent-reexamination>.
- No. 03 C 8100, 2004 U.S. Dist. LEXIS 15918, at *9 (E.D. Ill. Aug. 10, 2004).
- Id.*
- Id.* at *10-11.
- 217 U.S.P.Q. 1032 (N.D. Tex. 1982).
- 11 U.S.P.Q.2d 1703 (N.D. Ohio 1989).

USPTO Updates Effective Date of "Track One" Fast-Track Patent Processing

USPTO to begin accepting requests for prioritized examination of patent applications on September 26, 2011

The United States Patent and Trademark Office (USPTO) has announced today plans for the agency to begin accepting requests for prioritized examination of patent applications through the Track One prioritized patent examination program now scheduled to go into effect on Monday September 26, 2011.

"Track One provides a comprehensive, flexible patent application processing model to our nation's innovators, offering different processing options that are more responsive to the real-world needs of our applicants," said Under Secretary of Commerce for Intellectual Property and Director of the USPTO David Kappos. "We are now in a position to offer this program which will bring the most important new products and services to market more quickly, helping to build businesses and create new jobs in America."

Track One, which is part of the USPTO's Three-Track Program, will provide applicants with greater control over when their applications are examined and promote greater efficiency in the patent examination process. Track One will allow inventors and businesses, for a fee, to have their patents processed within 12 months.

The application must be an original utility or plant nonprovisional application filed under 35 U.S.C. 111(a) on or after September 26, 2011, the new effective date of the Track One final rule.

The Federal Register notice announcing the implementation of Track One is now available for review here. <http://www.gpo.gov/fdsys/pkg/FR-2011-09-23/html/2011-24467.htm>