



Licensing Strategy and Negotiation



The New Declaratory Judgment Test Through The Eyes of the Federal Circuit, and Its Impact on the Future of Licensing Negotiations

By: Artem N. Sokolov

Patent licensing is the bread and butter of patent revenue for most corporations. Although patents are but a part of the overall business strategy of a corporation, a well

thought-out and developed patent portfolio can not only prevent a competitor from entering the market, but can also generate a steady revenue stream over the life of the patent. Effective licensing negotiations provide the patent holder with the ability to reach this goal. Although licensing negotiations always carry a risk of a lawsuit, previous Federal Circuit decisions allowed counsel to develop a reliable approach for entering licensing discussions.

In this approach, initiating licensing discussions with a potential infringer typically begins with a letter, informing the potential infringer as to the existence of a patent covering the potentially infringing product, and possibly providing an offer to license (hereinafter "licensing letter"). Ideally, the goal of this licensing letter is to start a discussion, which would hopefully lead to an acceptable licensing agreement. However, in a less ideal scenario, the letter, such as the one described above, may provide the potential infringer with the ability to bring a declaratory judgment action. A recent Supreme Court decision and Federal Circuit cases which follow it, suggest that the less ideal scenario is now much more likely.

In October of 2006, the Supreme Court in *MedImmune v. Genentech* called into question the long-standing "reasonable apprehension" test, developed by the Federal Circuit to determine whether a "case or controversy" for the purpose of a declaratory judgment action has been met.¹ The Federal Circuit has also followed suit, relying on *MedImmune* to find declaratory judgment jurisdiction where none previously existed.² The result is an effectively lower threshold for establishing a "case or controversy" in declaratory judgment actions.

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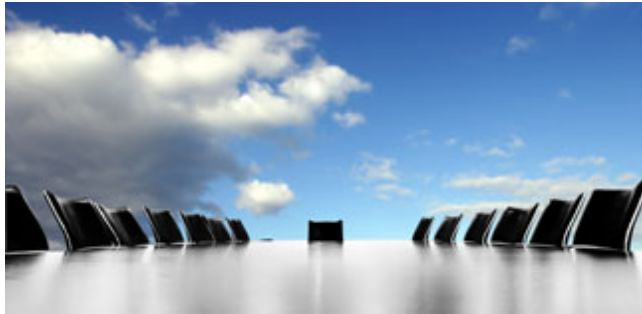
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Although the *MedImmune* decision was limited to cases involving existing license holders, the Federal Circuit in *SanDisk v.*

STMicroelectronics, extended the reach of the declaratory judgment test to

include even potential licensees. The impact of these decisions is instant, and at least one Judge has taken note. Justice Bryson, although concurring in *SanDisk*, warned that "the rule adopted by [the Federal Circuit] ... will effect a sweeping change in our law regarding declaratory judgment jurisdiction."



The present reality, in light of *MedImmune* and *SanDisk*, is that declaratory judgment actions are more readily available to parties who are approached by patentees seeking to license their patents. As such, understanding the impact of these recent decisions, and adjusting accordingly, is important for both in-house, and outside counsel. Specifically, issues such as licensing strategy, the approach to sending and responding to various licensing letters, providing potential infringers with notice, as well as forum choice considerations all need to be re-evaluated in light of the current developments in declaratory judgment law.³

I. The Changing Landscape of the Declaratory Judgment Law in Light of *MedImmune* and *SanDisk*

The "case or controversy" requirement for filing a declaratory judgment action is found in the U.S. Constitution,⁴ but has also been codified as the Declaratory Judgment Act.⁵ Prior to *MedImmune*, courts applied a so-called, "reasonable apprehension" test to determine whether a "case or controversy" existed for the purpose of filing a declaratory judgment action. This test provided the declaratory judgment plaintiff with a "case or controversy" in situations where:

1. conduct by the patentee created a reasonable apprehension on the part of the declaratory judgment plaintiff that it will face an infringement suit, and
2. conduct by the declaratory judgment plaintiff amount[ed] to infringing activity or demonstrate[ed] concrete steps taken with the intent to conduct such activity.⁶

If both elements of the test are met, a "case or controversy" for the purpose of a declaratory judgment action exists. The "reasonable apprehension" test led to a somewhat ideal case for the patent holder. Before *MedImmune*, a patent holder who wanted to initiate licensing negotiations, may have been able to request for the opposing party to take a license and pay royalties as well as put that opposing party on

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notice for the purpose of damages, all without reaching the threshold for a "case or controversy," and thus avoiding a declaratory judgment suit.⁷

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Such is no longer the case. The recent decisions in *MedImmune* and *SanDisk* make it clear that companies can no longer have it both ways. In fact, now, "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."⁸ In this regard, *MedImmune* has articulated a new test for determining whether declaratory judgment jurisdiction exists, and this test has been adopted by the Federal Circuit. Now, declaratory judgment jurisdiction exists where:

under all the circumstances, [the facts alleged] show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.⁹

In *SanDisk*, the Federal Circuit, for the first time, applied the new standard for a declaratory judgment action. Recognizing the breadth of the totality-of-circumstances approach adopted by *MedImmune*, the court in *SanDisk* further explained that, declaratory judgment jurisdiction may be had where, "a patentee asserts rights under a patent based on certain identified ongoing or planned activity of another party,"¹⁰ and "that party in turn contends that it has the right to engage in the accused activity without license."¹¹ It seems however, that *SanDisk's* holding is limited to declaratory judgment issues involving licensing activity by the patentee.

The declaratory judgment standard, through the eyes of the Federal Circuit, at the very least, lowers the bar for declaratory judgment plaintiffs to get into court. However, Justice Bryson painted a much bleaker future in his *SanDisk* concurrence. Although agreeing with the decision in view of *MedImmune*, Justice Bryson lamented that "it would appear that under the court's standard virtually any invitation to take a paid license relating to the prospective licensee's activities would give rise to an Article III case or controversy."¹²

Whether future decisions will indeed implement such a broad standard



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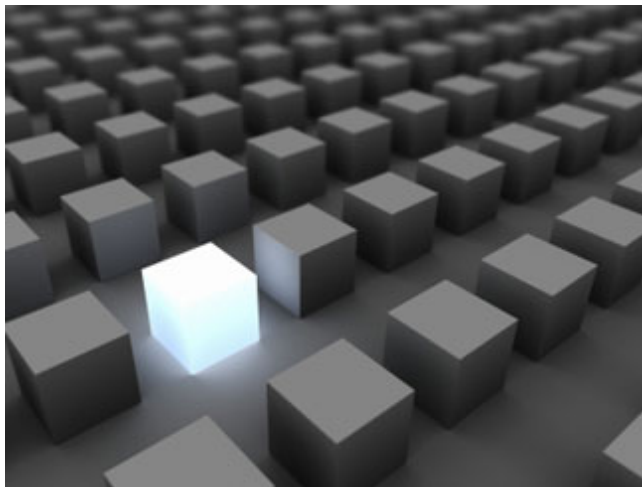
remains to be seen.

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II. The Impact of the New Standard on Current Licensing and Negotiation Practice

There is little doubt that the standard for bringing a declaratory judgment action has significantly changed. However, recognizing the impact of these decisions on current licensing practice will allow one to shape their business strategy for the future. As previously mentioned, *SanDisk* extended the reach of declaratory judgment jurisdiction to include, not only existing license holders, but also potential licensees.



Thus, *SanDisk* in particular will have the greatest impact on shaping the future approach to licensing and negotiation practice. Several issues are particularly important to consider.

A. The Effect on Aggressive Licensing Tactics

By lowering the standard needed to establish a "case or controversy" for a declaratory judgment action, courts have liberalized the availability of declaratory judgment relief and provided prospective licensees with powerful ammunition to take into a licensing negotiation.¹³ This is particularly true for parties who believe that they have a potential defense, and are thus less likely to consider taking a license.


The impact of this liberalization is also demonstrated by its effect. By lowering the threshold required for declaratory judgment jurisdiction, *SanDisk* effectively eliminated the patentee "safe haven" for licensing negotiations. Before *SanDisk*, courts treated a patentee's request for the potential infringer to take a license as simply an "exercise of lawful commercial prerogatives."¹⁴ This is no longer the case. Now, if a patentee puts a potential infringer in the "position of either pursuing arguably illegal behavior or abandoning that which he claims a right to do," a "case or controversy" for the purpose of filing a declaratory judgment action is created.¹⁵ Even before *MedImmune*, a party aggressively asserting its patents could expect to eventually end up in court. After *MedImmune*, however, the day in court could come much sooner. After *MedImmune*, a party aggressively asserting its patents should be ready, and expect, to go to court.




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As it stands now, even an offer to take a license may provide the opposing party with jurisdiction necessary to bring a declaratory judgment action. However, even if a prospective licensee receives an offer to take a license, drafted to avoid the declaratory judgment threshold under *MedImmune* and *SanDisk*, that prospective licensee has at least two options available.

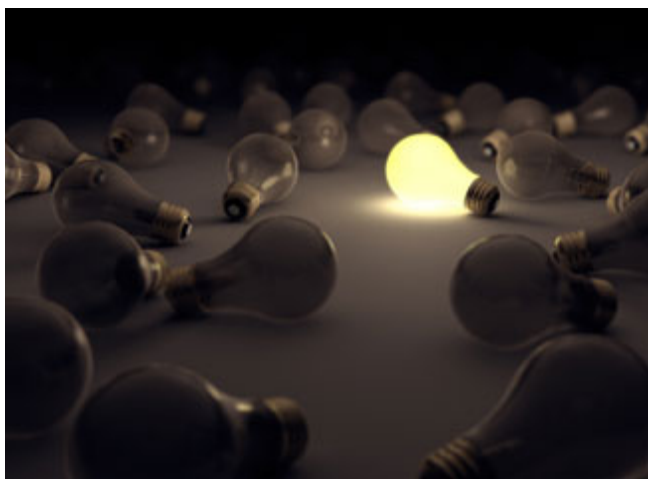
First, as noted by Justice Bryson in his concurrence:

the prospective licensee [can] dispel any doubt [by] inquire [ing] 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.¹⁶

Second, even if the prospective licensee is willing to entertain the patentee's offer, and negotiations do begin, the prospective licensee is no longer required to "bet the farm" by cutting off licensing negotiations in order to create a real controversy before bringing a declaratory judgment suit.¹⁷

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The resulting impact of *SanDisk*, indicates that the approach to drafting licensing letters should be rethought. Now, anyone drafting a licensing letter, in view of *SanDisk*, should keep in mind the purpose of such a letter: to begin a dialogue between the patentee and the potential

licensee. For example, even under Justice Bryson's extreme view, there must be at least an offer to license.¹⁸ Thus, in view of *SanDisk*, it may be appropriate to couch the initial letter as an "initial investigation" into the other party's product, or an "information request." The implication of the word "investigation" being that the patentee is on a fact gathering mission, and until all of the facts are gathered, the patentee cannot in good faith accuse anyone of infringement. If an accusation of infringement is not even implied, it seems unlikely that the threshold for filing a declaratory judgment action would be satisfied even under the broader *MedImmune* test.

Once initial discussions have begun, another tactic that the patentee's



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counsel may want to consider is requiring a confidentiality agreement during the negotiation of a license. This confidentiality agreement would be drafted to explicitly exclude any statement made during licensing negotiations from being admissible, for any purpose, including for the purpose of establishing jurisdiction for a declaratory judgment.¹⁹ Although no confidentiality agreement existed in *SanDisk*, the court suggested that entering such a confidentiality agreement may have allowed STMicroelectronics to avoid a declaratory judgment action.²⁰

The old saying goes "nothing ventured, nothing gained." In this instance, requesting a confidentiality agreement allows one to gain information. For example, if the potential licensee refuses, this indicates that the likelihood of a declaratory judgment action is increased. However, if the potential licensee is in fact interested in negotiating, a confidentiality agreement, which provides some incentives to the prospective licensee, may well be a suitable option. Regardless, the information gained by asking allows the patentee to modify the next step accordingly.

B. The Effect of the New Standard on Actual Notice under 35 U.S.C. § 287 (a)

In patent litigation, an accused infringer will only be liable for damages from the time of notice of the potential infringement.²¹ Notice may be had by either, actually informing the opposing party of their potential infringement, i.e., actual notice, or, providing constructive notice to the world by marking the article with a patent number. Without marking the product, damages may only be recovered after actual notice is provided. Importantly, satisfying the requirements for notice not only starts the clock for damages, but also opens the possibility of receiving enhanced, or punitive, damages.²²

To the extent that it was possible to provide actual notice of infringement in the past, without creating a "case or controversy," this is no longer the case. In the past, at least one case held that "[t]he criteria for actual notice under § 287(a) are **not** coextensive with the criteria for filing a declaratory judgment action."²³ Now, a comparison between the current standard for a declaratory judgment and the standard for actual notice set forth by *SRI Int'l* all but eliminates this possibility.

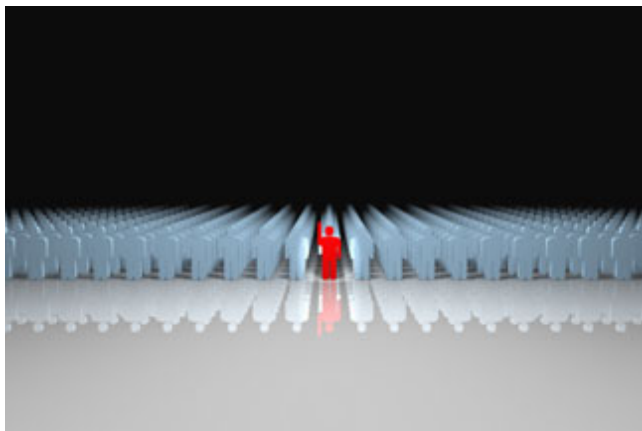
Consider the following comparison. The "actual notice requirement of § 287(a) is satisfied when the recipient is informed of the *identity of the patent and the activity that is believed to be an infringement*, accompanied by a *proposal to abate the infringement*, whether by license or otherwise."²⁴ This requirement is only met when the accused infringer is informed with *sufficient specificity*, that he may be infringing.²⁵ One example of actual notice under *SRI Int'l*, which did not expose the patentee to a declaratory judgment action, involved a patentee offering the opposing party a license.²⁶

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The current standard for declaratory judgment jurisdiction, in potential licensing situations, only requires the patentee to assert his rights under a patent *based on certain identified ongoing or planned activity*, and if the potential licensee



declines to take a license, the totality-of-circumstances test for declaratory judgment jurisdiction is satisfied.²⁷ Moreover, as previously mentioned, under the new standard, *any* offer of a license may now satisfy the standard for a declaratory judgment action.²⁸

Although this issue has not yet been settled in court, it seems very unlikely that a patentee will continue to be able to provide "actual notice" to potential infringers, without exposing himself to a potential declaratory judgment action. At least one solution to avoid an unwanted declaratory judgment action, however, is to refrain from providing actual notice through licensing letters, and instead, marking articles clearly thus providing constructive notice under 35 U.S.C. § 287.

III. Licensing Your Patents in the Wake of SanDisk

Regardless of which side of the negotiation one ends up on, it is important to realize that the standard has changed. Along with the standard, the options available to both parties have changed. Hence, for at least the near future, patentees should approach potential licensing negotiations with an increased level of caution.

The Court will revisit this issue again, that much is certain. In fact, the Federal Circuit shied away from providing definite guidelines in *SanDisk*, stating: "[we] need not define the outer boundaries of declaratory judgment jurisdiction."²⁹ However, because the Federal Circuit has adopted the "totality-of-circumstances" test, as articulated in *MedImmune*, future cases will be decided on a case-by-case basis.³⁰

Although future cases will help shape where the court draws the proverbial "line in the sand," it may be helpful to review the facts relied on by the court in *SanDisk* to establish declaratory judgment jurisdiction in a licensing context.³¹

For example, STMicroelectronics (ST) provided SanDisk with a thorough infringement analysis, including an element-by-element breakdown of SanDisk's alleged infringement, which was presented by "seasoned litigation experts." ST also specifically identified SanDisk's products, which ST alleged infringed its identified patents. Additionally, throughout ST's presentation, ST's representatives continuously referred to SanDisk's products as "infringing." Finally, ST provided SanDisk with "a packet of materials, over 300 pages in length, containing, for each of ST's fourteen

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patents under discussion, a copy of the patent, reverse engineering reports for certain of SanDisk's products, and diagrams showing a detailed infringement analysis of SanDisk's products."³² Taking the above facts in combination, the CAFC found that ST "had made a studied and determined infringement determination and asserted the right to a royalty based on this determination."³³ When SanDisk, in turn, asserted that its on-going activity was legal, the new test for declaratory judgment jurisdiction was satisfied.³⁴ Moreover, consistent with the totality-of-circumstances approach, the court noted that a patentee's "course of conduct" is an important consideration for the purposes of the declaratory judgment action.³⁵ That is, the entire course of conduct should be evaluated, and jurisdiction will not be mooted by self-serving statements inconsistent with that conduct.

With the above in mind, these cases should serve as a warning to both in-house and outside counsel: relying on past licensing strategies and practice will now likely land you in court. As such, both in-house, and outside counsel should continue to monitor the issues presented by this case as they develop in the next several years. Moreover, while cases applying the new test make their way through the courts, it is best to approach licensing negotiations, including sending and responding to licensing letters, with an abundance of caution.

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1. See generally *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764 (2006).
2. *SanDisk Corp. v. STMicroelectronics, Inc.*, 82 U.S.P.Q. 2d 1173 (Fed. Cir. 2007). The Federal Circuit has also applied the new *MedImmune* declaratory judgment test in *Teva Pharm., Inc. v. Novartis Pharm. Corp.* 82 U.S.P.Q. 2d 1225 (Fed. Cir. 2007). However, because *Teva* did not involve a licensing dispute, it will not be discussed herein.
3. *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1183.
4. U.S. CONST. art. III, § 2, cl. 1.
5. See 28 U.S.C. § 2201(a) (2006).
6. See *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1178 (citing *Arrowhead Indus. Water, Inc. v. Ecolochem, Inc.*, 846 F.2d 731, 737 (Fed. Cir. 1988)).
7. See *SRI Int'l, Inc. v. Advanced Tech. Labs., Inc.*, 127 F.3d 1462, 1470 (Fed. Cir. 1997) ("actual notice may be achieved without creating a case of actual controversy in terms of 28 U.S.C. § 2201.").
8. *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1179-1180; see also *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764, 772 (2006).
9. *MedImmune, Inc.*, 127 S. Ct. at 772 (citing *Md. Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273 (1941)).
10. Importantly this right includes not only the right to prevent an accused infringer from practicing the patentee's invention, but also a right to royalty under the patent. *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1180.
11. *Id.* at 1180.
12. *Id.* at 1182. (emphasis added). In this context, it is important to note that while the majority declined to define the outer boundaries of declaratory judgment jurisdiction, at

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least some affirmative act by the patentee is still required. Id. at 1179 (emphasis added).

13. For example, one benefit to an accused infringer to file a Declaratory Judgment instead of waiting to be sued, is to litigate the case in the forum of his choice. For other advantages and strategies available to a declaratory judgment plaintiff, see "Pulling the Preemptive Trigger" Managing Intellectual Property, William H. Mandir, John F. Rabena, (October, 2003).

14. *Cygnus Therapeutic Sys. v. ALZA Corp.*, 92 F.3d 1153, 1160 (Fed. Cir. 1996).

15. *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1180.

16. Id. at 1182

17. Id. at 1181 (citing *MedImmune, Inc.*, 127 S. Ct. at 772). As a result, *SanDisk* overrules *Phillips Plastics Corp. v. Kato Hatsujou Kabushiki Kaisha*, 57 F.3d 1051, 1053 (Fed. Cir. 1995) ("When there are proposed or ongoing license negotiations, a litigation controversy normally does not arise until the negotiations have broken down.").

18. Justice Bryson asserts that an offer to license "is accompanied by a suggestion that the other party's conduct is within the scope of the patentee's patent rights [and that] the rationale underlying a license offer is the patentee's express or implied suggestion that the other party's current or planned conduct falls within the scope of the patent." *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1182.

19. Such a confidentiality agreement would have to be proposed at an early enough stage of the licensing discussion so that the standard for declaratory judgment would not yet have been satisfied.

20. Id. at 1175 n.1. But see Id. at 1183 n.1 (J. Bryson, concurring) ("The problem with [requiring a confidentiality agreement] is that it would normally work only when it was not needed--only a party that was not interested in bringing a declaratory judgment action would enter into such an agreement. A party that contemplates bringing a declaratory judgment action or at least keeping that option open would have no incentive to enter into such an agreement.").

21. See 35 U.S.C. § 287(a) (2006).

22. See 35 U.S.C. § 284 (2006) (authorizing the court to "increase the damages up to three times the amount found or assessed.").

23. *SRI Int'l, Inc. v. Advanced Tech. Labs, Inc.*, 127 F.3d 1462, 1470 (Fed. Cir. 1997) (emphasis added) (holding that the "statutory purposes [of these Acts] are distinct, serve different policies, and are governed by different laws [and that] [a]ctual notice may be achieved without creating a case of actual controversy in terms of 28 U.S.C. § 2201.").

24. Id. (emphasis added)

25. Id.

26. Id. ("the offering of a license is actual notice.").

27. *SanDisk Corp. v. STMicroelectronics, Inc.*, 82 U.S.P.Q. 2d 1173, 1180 (Fed. Cir. 2007).

28. Id. at 1182. In this context, it is important to note that while the majority declined to define the outer boundaries of declaratory judgment jurisdiction, at least some affirmative act by the patentee is still required. Id. at 1179.

29. Id.

30. Id. at 1178; see also *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273 (1941).

31. The facts of *Teva Pharm., Inc. v. Novartis Pharm. Corp.*, 82 U.S.P.Q. 2d 1225 (Fed. Cir. 2007), another case relying on the newly minted declaratory judgment standard, are not helpful in a licensing context, and thus their discussion is omitted.

32. *SanDisk Corp.*, 82 U.S.P.Q. 2d at 1180-1181.

33. Id.

34. See id. at 1180 (finding that declaratory judgment jurisdiction is satisfied when: 1) a patentee asserts rights under a patent based on certain identified ongoing or planned activity of another party, and 2) that party in turn contends that it has the right to engage in the accused activity without license).

35. Id. at 1181.

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