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PATENTS

The authors provide details of the circuit split on what is required to enforce no-challenge clauses in patent dispute settlement agreements.

No-Challenge Clauses in Patent Licenses



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Recently, in *Rates Technology, Inc. v. Speakeasy, Inc.*,¹ the U.S. Court of Appeals for the Second Circuit held that a provision in a pre-litigation settlement agreement that precluded a patent licensee from challenging the underlying patent's validity was unenforceable as against public policy. The decision expanded on the Supreme Court's holding in *Lear, Inc. v.*

¹ 685 F.3d 163, 103 U.S.P.Q.2d 1462 (2d Cir. 2012) (84 PTCJ 463, 7/20/12), cert. denied, No. 12-402, 81 U.S.L.W. 3199 (U.S. Jan. 14, 2013) (85 PTCJ 377, 1/18/13).

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Adkins, which required that a balance be struck between two competing policy interests. On the one hand, courts should seek to encourage settlement agreements by ensuring they are enforced, but on the other, courts should also seek to identify and challenge invalid intellectual property claims.²

The Federal Circuit, which has emphasized the importance of encouraging the settlement of patent disputes, has enforced no-challenge clauses even when made prior to any formal litigation.³ In contrast, decisions in both the Ninth and Second Circuits have stressed the policy of identifying and challenging invalid patents, recognizing that licensees are often in the best position—economically, technologically, or otherwise—to raise patent invalidity.

Against this backdrop of divergent jurisprudence, the Second Circuit weighed these policy goals in *Rates Technology* and joined the Ninth Circuit to hold that a no-challenge clause in a pre-litigation settlement agreement is unenforceable as against public policy.⁴

Policy Considerations

The disagreement between circuits is inextricably linked with the underlying policy rationales that each circuit seeks to promote. Despite their differences, the circuits seem to agree about the necessity of balancing various policy considerations. Where the circuits differ, however, is in how the relative importance of each policy should be weighted.

² See *Lear, Inc. v. Adkins*, 395 U.S. 653, 670, 162 U.S.P.Q. 1 (1969) (establishing balancing test to weigh competing policy considerations).

³ See, e.g., *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1363, 96 U.S.P.Q.2d 1521 (Fed. Cir. 2010) (80 PTCJ 656, 9/17/10) (finding clear and unambiguous contractual language is sufficient to bar invalidity claims).

⁴ *Rates Tech.*, 685 F.3d at 164.

Because it is the primary forum for patent disputes, the Federal Circuit has heightened incentives to encourage patent disputes to settle. If courts are unwilling to enforce certain provisions of settlement agreements, parties may be reluctant to settle because the agreed terms could later be challenged and held unenforceable. Thus, the interests of judicial economy and efficiency, as well as parties' freedom of contract, support enforcing no-challenge clauses in all settlement agreements, even those entered into pre-litigation.⁵

On the other hand, there is also significant a public interest in identifying and challenging invalid patents so that invalid claims they purport to protect can be dedicated to the common good.⁶ Free competition and use of ideas in the public domain are cornerstones of the American economy.⁷ While valid patents rightly reward an inventor with a limited monopoly to incentivize innovation, invalid patents constrain technological development that would otherwise be allowed to blossom in a free market. Therefore, other important policy interests suggest that no-challenge clauses should not be enforced, regardless of the context in which they are imposed.

State of the Law

Supreme Court

Rooted in contract law, the common law doctrine of licensee estoppel prohibits a party to a contract from both benefitting from the contract while simultaneously challenging the contract's terms. However, the licensee estoppel principle conflicts with the policy in favor of identifying and challenging invalid patents so that non-patentable ideas are available for public use.

In *Lear v. Adkins*, the Supreme Court confronted this inconsistency and held that the "technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued."⁸ As a result, the Court determined that, at least with respect to an ordinary license, licensee estoppel does not bar a licensee from challenging a patent's validity. In rationalizing this conclusion, *Lear* also laid the groundwork for the balancing test used to weigh the competing policy considerations.

Expanding on *Lear*, the court has repeatedly invalidated no-challenge clauses for policy reasons in anti-trust suits. In *Katzinger v. Chicago Metallic Manufacturing*, the court allowed a licensee to challenge a patent's validity after finding that price-fixing provisions in the license agreement were an illegal restraint of trade.⁹ In *U.S. v. Glaxo Group*, the court held that, in an anti-trust dispute, the public's interest in free competition

can override contractual commitments and allow licensees to challenge patents they are contractually prohibited from challenging.¹⁰

More recently, in *MedImmune v. Genentech*, the court held that a licensee need not repudiate a license agreement before challenging the underlying patent's validity.¹¹ Thus, by reversing the Federal Circuit's narrow interpretation of a licensee's rights to challenge patents, the court reiterated the policy preference of allowing invalid patents to be challenged.

Federal Circuit

Since the Supreme Court's decision in *Lear*, the Federal Circuit has refused to disregard the doctrine of licensee estoppel in patent disputes. Instead, the court has adopted a standard under which the clarity and specificity of a no-challenge clause are the most important factors in determining the clause's enforceability. Thus, if a no-challenge clause uses sufficiently "clear and unambiguous language," the Federal Circuit will bar licensees from challenging the patent's validity.¹²

In *Flex-Foot*, the Federal Circuit examined a settlement agreement that was voluntarily entered into and contained a waiver of the licensee's ability to challenge the validity of the underlying patent.¹³ Because the prescribing language was sufficiently "clear and unambiguous," the licensee was estopped from challenging the patent's validity, and the no-challenge clause was held to be consistent with public policy. The court summarized its analysis:

Once an accused infringer [(1)] has challenged patent validity, [(2)] has had an opportunity to conduct discovery on validity issues, and [(3)] has elected to voluntarily dismiss the litigation with prejudice under a settlement agreement containing a clear and unambiguous undertaking not to challenge validity and/or enforceability of the patent in suit, the accused infringer is contractually estopped from raising any such challenge in any subsequent proceeding.¹⁴

The Federal Circuit subsequently expanded this "clear and unambiguous" standard in *Baseload Energy v. Roberts*, concluding that the initiation of litigation proceedings was unnecessary in deciding whether a no-challenge clause is enforceable.¹⁵ As a result, *Baseload Energy* apparently abrogated the discovery requirement of the circuit's own *Flex-Foot* analysis. The court seemed to conclude that, in the context of settlement agreements, clear and unambiguous language is sufficient to bar a licensee's right to challenge a patent's validity, even if no invalidity claims had actually been litigated.¹⁶ In support of its decision, the court emphasized that "while the absence of a prior dispute and litigation

¹⁰ *United States v. Glaxo Group Ltd.*, 410 U.S. 52, 58 (1973), 176 U.S.P.Q. 289 ("[B]ecause of the public interest in free competition . . . the private licensee-plaintiff in an antitrust suit may attack the validity of the patent under which he is licensed even though he has agreed not to do so in his license.").

¹¹ *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 81 U.S.P.Q.2d 1225 (2007) (73 PTCJ 242, 1/12/07).

¹² *Baseload Energy*, 619 F.3d at 1362.

¹³ *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1369-70, 57 U.S.P.Q.2d 1635 (Fed. Cir. 2001) (61 PTCJ 349, 2/9/01).

¹⁴ *Id.* at 1370.

¹⁵ *Baseload Energy*, 619 F.3d 1357.

¹⁶ *Id.* at 1363 ("[C]lear and unambiguous language barring the right to challenge patent validity in future infringement actions is sufficient, even if invalidity claims had not been previously at issue and had not been actually litigated.").

⁵ See *Baseload Energy*, 619 F.3d at 1361 (weighing policy interests that favor enforcement of voluntary settlement agreements).

⁶ *Lear*, 395 U.S. at 668 (noting federal policy requires that "all ideas in general circulation be dedicated to the common good, unless they are protected by a valid patent").

⁷ *Id.* at 670 (finding an "important public interest in permitting full and free competition in the use of ideas").

⁸ *Id.* at 670-71.

⁹ *Katzinger Co. v. Chi. Metallic Mfg. Co.*, 329 U.S. 394, 402, 72 U.S.P.Q. 18 (1946) (finding contractual agreements to not challenge a patent's validity cannot override congressional policy any more than implied estoppel can).

as to invalidity is pertinent, we do not think that a settlement agreement is ineffective to release invalidity claims unless the exact circumstances described in *Flex-Foot* are present.”¹⁷

Flex-Foot and *Baseload Energy* demonstrate that the Federal Circuit views *Lear*'s policy against enforcing invalid patents as less important than encouraging the settlement of patent disputes. In other words, the Federal Circuit takes the position that enforcement of a no-challenge clause in a pre-litigation settlement agreement against a licensee is consistent with public policy objectives.

Other Circuit Decisions

Other circuits that have considered no-compete clauses have viewed them with significantly greater skepticism than the Federal Circuit.

In *Massillon-Cleveland-Akron Sign v. Golden State Advertising*, the Ninth Circuit explicitly held that the policy considerations of enforcing contractual covenants that restrict a licensee's ability to contest a patent's validity are outweighed by the broader policy goals of identifying and challenging invalid patents.¹⁸ Thus, in the Ninth Circuit, a no-challenge clause in a settlement agreement entered into prior to litigation is “void on its face and unenforceable.”¹⁹

Since *Massillon*, decisions from other circuits have reinforced the Ninth Circuit's conclusion that no-challenge clauses do not prevent a licensee from disputing the licensed patent's validity, even if the license arose from a settlement agreement.

In *Kraly v. National Distillers and Chemical*, the Third Circuit held that a licensee could challenge a licensed patent even though the license agreement contained an express no-challenge clause and was entered into through a consent decree to settle an infringement action.²⁰ In holding that a licensee need not repudiate a license agreement before challenging a patent's validity, the Second Circuit's decision in *Warner-Jenkinson* echoed *Lear*'s assessment that “removing restraints on commerce caused by improperly held patents should be considered more important than enforcing promises between contracting parties.”²¹

In *Rates Technology*, the Second Circuit also agreed with the *Massillon* rationale and held that pre-litigation settlement agreements between patent licensees and licensors, in the absence of any attempt to litigate the underlying patent's validity, are unenforceable as a matter of public policy.²² *Rates Technology* distinguished the Federal Circuit's *Flex-Foot* decision by holding that a different standard applies once litigation has been initiated. Specifically, *Rates Technology* highlighted four distinct ways that patent disputes can be resolved: (1) a litigated final decision by a court; (2) entry of a consent decree following litigation; (3) private settlement after

litigation has begun; and (4) private agreement before the initiation of litigation.²³

While *Rates Technology* did not address exactly when sufficiently clear no-challenge clauses in post-litigation agreements may become enforceable, the court determined that no-challenge clauses in pre-litigation settlement agreements are unenforceable as against public policy.²⁴

Practical Implications

The circuits are divided on what is required to enforce no-challenge clauses in settlement agreements. The Federal Circuit has been resolute in enforcing no-challenge clauses found to be clear and unambiguous. Other circuits have found no-challenge clauses unenforceable as contrary to public policy, no matter how clear and unambiguous.

The Ninth Circuit's decision in *Massillon* and some concurring decisions from other circuits, while still good law, were decided in the 1970's, before the Federal Circuit was established. However, *Rates Technology* may presage a trend toward holding no-challenge clauses unenforceable, particularly in pre-litigation settlement agreements.

Perhaps just as important as the actual *Rates Technology* decision was the Federal Circuit's finding that it lacked jurisdiction to hear the appeal. Citing *Laboratory Corp. of America Holdings v. Metabolite Laboratories, Inc.*,²⁵ the Federal Circuit concluded that the issue was solely a contractual dispute and did not require resolving a related question of patent law.²⁶

If the Federal Circuit continues to view no-challenge clauses as outside its realm of limited jurisdiction, it is likely that the enforceability of no-challenge clauses will be more frequently raised and addressed in other circuits, which may result in even greater divergence of the courts with regard to their enforceability.

As yet, it seems unclear how *Rates Technology* will affect the legal landscape, whether it will breathe new life into these older opinions, and what impact it will have on other circuits that confront the enforceability of no-challenge clauses. Moreover, because the Supreme Court has denied certiorari for the *Rates Technology* case, no reconciliation of the divergence in the circuits is imminent.

With this uncertainty in mind, patent holders seeking to contractually limit a licensee's ability to challenge a licensed patent must tread carefully. For now, it appears that in the wake of *Rates Technology*, *Massillon*, and the Federal Circuit decisions, the likelihood that a no-challenge clause will be enforced is related to the initiation and extent of litigation disputing a patent's validity. No-challenge provisions in settlement agreements that are entered into pre-litigation are less likely to be enforceable, at least outside the Federal Circuit. However, similar provisions entered into via consent decrees are probably more likely to be afforded estoppel effect.

¹⁷ *Id.*

¹⁸ *Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co.*, 444 F.2d 425, 170 U.S.P.Q. 440 (9th Cir. 1971).

¹⁹ *Id.* at 427.

²⁰ *Kraly v. Nat'l Distillers & Chem. Corp.*, 502 F.2d 1366, 1369, 183 U.S.P.Q. 79 (3d Cir. 1974).

²¹ *Warner-Jenkinson Co. v. Allied Chem. Corp.*, 567 F.2d 184, 188, 193 U.S.P.Q. 753 (2d Cir. 1976); see also *Am. Sterilizer Co. v. Sybron Corp.*, 526 F.2d 542, 188 U.S.P.Q. 97 (3d Cir. 1975) (allowing licensee to challenge validity of patent without repudiating license agreement).

²² *Rates Tech.*, 685 F.3d 163.

²³ *Id.* at 169-71.

²⁴ *Id.* at 174.

²⁵ 599 F.3d 1277, 1283-84, 94 U.S.P.Q.2d 1224 (Fed. Cir. 2010) (79 PTCJ 591, 3/19/10).

²⁶ *Rates Tech., Inc. v. Speakeasy, Inc.*, 437 Fed. Appx. 940, 941 (Fed. Cir. 2011).

Conclusion

Rates Technology appears to create a spectrum, pursuant to which the enforceability of a settlement agreement's no-challenge clause is tied to how far litigation regarding the patent's validity has proceeded. While this departs from the Federal Circuit's approach in

Flex-Foot and *Baseload Energy*, no clear consensus has yet appeared, and other circuits are likely to consider the issue of no-challenge clauses entered into through settlement agreements with increasing frequency.

They may conclude, as the Second and Ninth Circuits have, that such provisions can be challenged and may be unenforceable in many circumstances.