LITIGATION PERSPECTIVE ON LICENSING

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Introduction

Licensing technology normally results in the creation of a new relationship. As with all budding relationships, the parties should be optimistic about the future. But optimism is no substitute for pragmatism.

Since a relationship can sour, every license should be approached with an eye toward litigation. Ideally, the parties should anticipate disputes and tailor the agreement to reduce the time, effort and money spent in resolving them.

This paper is not intended to address all litigation-related subjects that should be considered during the licensing process; rather, it addresses only a handful of relevant issues.

I. EVIDENTIARY CONSIDERATIONS

The issues addressed in this section are relevant to any agreement, not just IP licenses. Because of the enormous exposure in many IP disputes, especially those involving patents, controlling the evidence that is considered by the fact finder can make the difference between victory and defeat.

A. LICENSING A STRANGER

The reference to a stranger is intended to characterize an entity that, prior to the license negotiations, did not use the patented technology. Negotiations with a stranger leading up to an executed license agreement, hence, should not fall within the purview of Rule 408, Fed. R. Evid.

While Rule 408 is not applicable to negotiations with a stranger, it nonetheless makes sense for the parties to agree on the discoverability and admissibility of oral communications made during the course of the negotiations. Irrespective of whether an agreement is totally or partially integrated, lawsuits involving the breach or interpretation of an agreement can devolve into a search for witnesses who can testify about some oral communication that may have an impact on the litigation. Much time, effort and money is spent on those discovery efforts.

When the agreement is totally integrated, the writing "may not be contradicted or supplemented" in order to show contractual intent. Joseph M. Perillo, *CALAMARI AND PERILLO ON CONTRACTS, FIFTH EDITION* § 3.4 (West 2003). The parties, however, may still spend an inordinate amount of time seeking discovery on the oral communications leading up to the agreement. ~~In certain jurisdictions, for example, an argument can be made that those oral communications should be admitted into evidence in order to show the intent of the parties and, therefore, breath life into the context of the obligations. *See, e.g.*, *Berg v. Hudesman*, 115 Wash. 2d 657, 667 (1990) ("Extrinsic~~

~~evidence is admissible as to the entire circumstances under which the contract was made, as an aid in ascertaining the parties' intent.")~~ **In California, for example, courts allow the terms set forth in a "complete and exclusive" contract to "be explained or supplemented by course of dealing or usage of trade or by course of performance." Cal. Code Civ. Prod. § 1856.** ***See, e.g., Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*****, 69 Cal. 2d 33, 37 (1968) ("The test of admissibility of extrinsic evidence… is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible"). Under California contract law, the English language is inherently ambiguous and, "[a]ccordingly, the meaning of a writing '…can only be found by interpretation in the light of all the circumstances that reveal the sense in which the writer used the words.'"** ***Id.*** **at 38 (quoting** ***Sales Corp. v. California Press Mfg. Co.*****, 20 Cal. 2d 751, 776 (1942)).**

The Ninth Circuit considered the effect of this rule in ***Trident Ctr. v. Connecticut Gen. Life Ins. Co.*****, 847 F.2d 564, 569 (9th Cir. Cal. 1988):**

> **Under** ***Pacific Gas*****, it matters not how clearly a contract is written, nor how completely it is integrated, nor how carefully it is negotiated, nor how squarely it addresses the issue before the court: the contract cannot be rendered impervious to attack by parol evidence. If one side is willing to claim that the parties intended one thing but the agreement provides for another, the court must consider extrinsic evidence of possible ambiguity.**

One way to attempt to avoid this arguably wasteful and expensive undertaking is to agree that oral communications leading up to the agreement may not be the subject of discovery, nor may they be offered into evidence or used for any purpose in any proceeding involving the interpretation of any provision of the agreement ("oral communications

exclusion agreement"). The exclusion provision does not apply to evidence otherwise discoverable merely because it is the subject of a communication.

Wigmore, with certain exceptions for fraud, duress or oppression, concluded that there was nothing "inherently impolitic" in an agreement to vary the rules of evidence. John Henry Wigmore, *Evidence in Trials at Common Law* 560 (Peter Tillers ed., Little, Brown and Company 1983). He concluded that such an agreement should be effective. *Id.*[1]

Some courts do not agree with Wigmore. In *Garden State Plaza Corp. v. S.S. Kresge Co.*, 78 N.J. Super. 485, 503 (App. Div. 1963), for example, the court refused to enforce a contractual provision that precluded the use of evidence of negotiations for interpreting the terms of a written lease. The court reasoned that it would not allow the parties to constrain it to performing a function with incomplete facts, which the court analogized to asking it to wear "judicial blinders." *Id.*

The Supreme Court has upheld an agreement that effectively waived Rule 410, Fed. R. Evid., concerning the admissibility of a statement made during plea discussions between a criminal defendant and a prosecutor. In *United States v. Mezzanatto*, 513 U.S. 196, 198 (1995), the accused conferred with his counsel and agreed with the prosecutor that any statements the accused made during the discussion with the prosecutor could be used to impeach any contradictory statements the accused made at trial. The accused then contradicted certain of his plea-discussion statements at trial, the prosecutor succeeded over defense counsel's objections to impeach the accused, and he was convicted. *Id.* at 199.

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[1] Wright & Graham agree that a provision varying the rules of evidence should be enforceable, particularly where it is in a "handmade commercial agreement" – rather than a "form contract" – and the parties have been assisted by counsel. 21 Charles Alan Wright & Kenneth W. Graham, Jr., Federal Practice and Procedure § 3059 (West Publishing Co. 1977).

The Ninth Circuit reversed, holding that the accused's agreement to allow admission of his plea statements for impeachment purposes was unenforceable, and the district court's admission of them error. *Id.* The Ninth Circuit reasoned that both Federal Rule of Evidence 410 and Federal Rule of Criminal Procedure 11(e)(6) – which, subject to certain exceptions, provide that statements made in the course of plea discussions between a criminal defendant and a prosecutor are inadmissible against the defendant – were subject to only two express exceptions, neither of which concerned waiver. *Id.* at 200. The Court concluded that Congress must have meant to preclude waiver agreements such as the accused's. *Id.*

The Supreme Court disagreed. The Court explained that "[r]ather than deeming waiver presumptively unavailable absent some sort of express enabling clause, we instead have adhered to the opposite presumption." *Id.* at 200-01. The Court explained that its interpretation of the Federal Rules of Criminal Procedure was consistent with this approach. *Id.* at 201. "The presumption of waivability has found specific application in the context of evidentiary rules." *Id.* at 202. Quoting Wright & Graham, the Court noted, "[a]bsent some 'overriding procedural consideration that prevents enforcement of the contract,' courts have held that agreements to waive evidentiary rules are generally enforceable even over a party's subsequent objections." *Id.* (citation omitted). After analyzing and rejecting the accused's arguments about why the Ninth Circuit's decision should stand, the Court concluded:

> We hold that absent some affirmative indication that the agreement was entered into unknowingly or involuntarily, an agreement to waive the exclusionary provisions of the plea-statement Rules is valid and enforceable.

Id. at 210.

After the Supreme Court upheld the evidentiary agreement in *Mezzanatto*, at least one Federal Court has

addressed the requirements for a knowing and voluntary agreement. In *United States v. Turner,* 157 F.3d 552 (8th Cir. 1998), for example, the court discussed the "two distinct dimensions" of a waiver of *Miranda* rights. The court stated that in order for a waiver to be enforceable, it should (1) be "voluntary" in the sense that it states that specific evidentiary rights are being waived, and (2) be "knowingly" in the sense that it states the consequences of the decision to abandon them.

The oral communications exclusion agreement should be a topic of discussion at the initiation of the negotiations and reduced to writing before substantive communications begin. **A cautious approach should result in an agreement which identifies the specific right being abandoned, as well as the consequences of the decision to abandon it.**

The practical effect of an oral communications exclusion agreement is that it forces the parties to articulate their positions in writing. Even those writings may be troublesome in litigation because they are most often written without consideration of the large number of disputes that could possibly arise after the agreement is executed. With the oral communications exclusion, however, no individual will be tempted to completely revise the history of the negotiations for either party.

B. LICENSING AS A COMPONENT OF SETTLEMENT

Many disputes are settled before litigation is initiated, and a majority of those cases that result in litigation are settled before trial. Many settlements involving IP rights include a license. Negotiations in the environment of a dispute or lawsuit require a more delicate touch than those conducted with a stranger.

Rule 408 of the Federal Rules of Evidence provides:

> Evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negativing a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

Rule 408 is generally invoked to exclude evidence of settlement negotiations, where that evidence is offered on the liability or damages issues. The policy of the Rule is to promote settlement of disputes. 2 Jack B. Weinstein & Margaret A. Burger, *Weinstein's Federal Evidence* § 408.02[1] (Joseph M. McLaughlin ed., Matthew Bender 2d ed. 2003). Weinstein points out that the benefit of the policy begetting such a broad rule is the reduction in court congestion and unnecessary lawsuits. *Id.*

Notwithstanding the laudable goals of Rule 408, however, clever lawyers can always manufacture an argument that the evidence of compromise is being offered for a reason other than establishing "liability for or invalidity of the claim or the amount." Rule 408, Fed. R. Evid. **Courts, for example, have admitted evidence of offers or agreements to compromise for purposes of rebuttal, for purposes of impeachment, or to show the defendant's knowledge and intent.** ***Stewart v. Wachowski, 2004 U.S. Dist. LEXIS 26607 (C.D. Cal., 2004).***

That circumstance should be avoidable if the parties agree that all communications made in connection with efforts to settle a claim or dispute cannot be the subject of any discovery, nor may they be used in any way in any

proceeding involving the subject matter of the settlement ("all communications exclusion agreement"). This agreement should include an exception similar to the one specified in Rule 408: The agreement does not apply to information which is otherwise discoverable merely because it was the subject of a communication.

Generally ~~Obviously~~, an all communications exclusion agreement will not prohibit discovery or use of the settlement communications by others who are not parties to the agreement. As with Rule 408, clever lawyers will attempt to find a way to have a third party discover those communications and offer them in evidence for some purpose other than that precluded by the Rule. There will be exceptions in certain circumstances that will counsel against the enforcement of a communications exclusion agreement of any kind. Wright & Graham, for example, note that the procedural impact of the contract should be questioned. 21 Federal Practice and Procedure § 3059. The Supreme Court has approved of this approach. *See United States v. Mezzanatto*, 513 U.S. at 202.

The Federal Rules of Evidence differ from the rules of evidence used in most state courts. Instead of specifically describing the nature of privileges (such as the attorney-client privilege and the settlement privilege), the Federal Rules of Evidence authorize courts to recognize and develop privileges "by the principles of the common law." Rule 501, Fed. R. Evid.

Rule 501 of the Federal Rules of Evidence provides:

> **Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. However, in civil actions and proceedings, with respect to an**

> **element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law.**

As interpreted by the Supreme Court in *Jaffee v. Redmond, 518 U.S. 1, (1996)*, Rule 501 "did not freeze the law governing the privileges of witnesses in federal trials at a particular point in our history, but rather directed federal courts to 'continue the evolutionary development of testimonial privileges.'" *Id.* at 9 (quoting *Trammel v. United States*, 445 U.S. 40, 47 (1980)).

In light of Rule 501 and *Jaffee*, the Sixth Circuit has recently created a new "settlement privilege" in *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc., 332 F.3d 976 (6th Cir. 2003)*. The Court reasoned that because "there exists a strong public interest in favor of secrecy of matters discussed by parties during settlement negotiations," and because "confidential settlement communications are a tradition in this country," it would be in the interest of the public to create a new "settlement privilege." *Id.* at 980. Under the new privilege, lawyers are prohibited from using Rule 408's "for another purpose" exception "to allow settlement *communications* into evidence for any purpose." *Id.* at 981. The exceptions in Rule 408, rather, can be "used only to admit the occurrence of settlement talks of the settlement agreement itself." *Id.* The "settlement privilege" of the Sixth Circuit seems -- in effect -- to assume that an "all communications exclusion agreement" occurs in every negotiation.

The Court in *Goodyear* found that "statements made in furtherance of settlement are privileged and protected from third-party discovery" under the settlement privilege. *Id.* at 977. This holding differs dramatically from the general rule that settlement negotiations are discoverable by third parties.

Since it remains to be seen whether more federal courts will adopt the Sixth Circuit's "settlement privilege," it certainly makes sense for parties to adopt a communications exclusion agreement.

Consider also that those who would rely on the Federal Circuit's "totality of the circumstances" test for evaluating willful infringement as a reason why an exclusion agreement should not be enforced should take note of *Advanced Cardiovascular Systems, Inc. v. Medtronic, Inc.*, 265 F.3d 1294 (Fed. Cir. 2001). In *Medtronic*, the Federal Circuit rejected the defendant's argument that the law requiring an evaluation of all the relevant circumstances to assess its willfulness did not alter the trial court's test for the admissibility of a settlement agreement and certain pre-settlement negotiations. *Id.* at 1308. The court reasoned that the totality of the circumstances applied only to what the trial court admitted into evidence. *Id.* This decision suggests that the willfulness test will not impact the enforceability of an exclusion agreement.

Notwithstanding the reality of the resourcefulness of lawyers, it still makes sense for parties to adopt an all communications exclusion agreement in order to facilitate the open and honest communications that are required to resolve a dispute. Before such an agreement is finalized, however, consideration should be given to issues such as notice of infringement, laches or estoppel, which may not be provable if the exclusion provision of the agreement is enforced.

II. VALIDITY DISPUTES AFTER LICENSING

A. PATENT DISPUTES

In 1969, the Supreme Court decided the landmark case of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), eliminating the licensee estoppel rule, which had precluded licensees from challenging the validity of a licensed patent. In concluding

that federal patent law preempted state contract law, the Court observed:

> Licensees may often be the only individual with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification.

Id. at 670.

In considering whether the licensee should be required to pay royalties during the ongoing litigation seeking to invalidate the licensed patent, the Court stated:

> The decisive question is whether overriding federal policies would be significantly frustrated if licensees would be required to continue to pay royalties during the time they are challenging patent validity in the courts.
>
> It seems to us that such a requirement would be inconsistent with the aims of federal patent policy. Enforcing this contractual provision would give the licensor an additional economical incentive to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning . . . . Lastly, enforcing this contractual provision would undermine the strong federal policy favoring the full and free use of ideas in the public domain.

Id. at 673-74.

Licensees must take active steps to enjoy the cessation in royalty payments that *Lear* affords. The Federal Circuit has stated that a licensee may not invoke *Lear's* protection "until it (i) actually ceases payment of royalties, and (ii) provides notice to the licensor that the reason for ceasing payment of royalties is because it has deemed the relevant claims to be invalid." *Studiengesellschaft Kohle, mbH. v. Shell Oil Co.*, 112 F.3d 1561, 1568 (Fed. Cir. 1997).

The *Lear* abrogation of licensee estoppel does not apply if a license is entered into as a part of a settlement of a patent

infringement lawsuit. In *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348, 349 (Fed. Cir. 1988), a patent infringement defendant entered into a settlement agreement obligating it to make license payments regardless of whether the patents were subsequently held invalid or enforceable. The settlement agreement – styled as a settlement "order" and signed by the parties, their lawyers, and the court – stated that "'the issues of validity, enforceability and infringement of' the patents in suit 'are hereby finally concluded and disposed of.'" *Id.* The defendant was barred from seeking relief from its royalty obligation to pay based on a subsequent decision finding the patents unenforceable. To permit that relief, according to the Federal Circuit, would weaken the effectiveness of settlements and decrease the willingness of parties to settle. *Id.* at 350. The Federal Circuit distinguished *Lear*, observing that *Lear* did not involve settlement of a lawsuit, but only a licensee's right to challenge the validity of the licensed patent. *Id.*

A party to a consent judgment also cannot invoke *Lear*. The Federal Circuit determined that *Lear* does not override the claim preclusion that attaches to a consent judgment. *Foster v. Hallco Mfg. Co.*, 947 F.2d 469, 476-77 (Fed. Cir. 1991). The case before the court, however, concerned a different product than the one addressed by the consent judgment. The Federal Circuit explained that, for claim preclusion to apply, the proponent of the defense had the ultimate burden of showing that there were not "material differences" between the new device and the old one. *Id.* at 480. Turning to issue preclusion, the court stated that the parties could craft a consent judgment to foreclose a validity challenge when a different product was involved if that provision was drafted narrowly and specifically. *Id.* at 480-81. This language suggests that parties can contract away IP defenses if done with specificity.

A request for reexamination did not violate a settlement agreement where the accused had agreed not to file suit challenging the validity of the patent in "any United States

court." *Joy Mfg. Co. v. Nat'l Mine Services Co.*, 810 F.2d 1127, 1129 (Fed. Cir. 1987). The Federal Circuit indicated in dicta that, as part of settlement, a party could agree to not challenge validity, administratively or otherwise. *Id.* at 1130.

B. COPYRIGHT DISPUTES

It is not clear whether the type of licensee estoppel abrogated by *Lear* can still be used in copyright disputes. For example, the Seventh Circuit addressed whether a validity no-contest in a copyright license was enforceable. *Saturday Evening Post v. Rumpleseat Press, Inc.*, 816 F.2d 1191, 1193 (7th Cir. 1987). The court distinguished *Lear* on its facts, reasoning that a negotiated clause was different from the default no-contest clause that *Lear* read into every contract. *Id.* at 1200. It left open the question of the viability of licensee estoppel where the licensee did not explicitly address the licensee's freedom to contest the validity of the licensed copyright. The Seventh Circuit went on to make two holdings, both favoring the right to contract away a validity contest:

> So we have a narrow and a broad holding on no-contest clauses: they are valid in copyright licenses (broad); they are valid when no issue of copyrightability is presented (narrow).

Id. at 1201.

C. TRADEMARK DISPUTES

Despite *Lear*, licensee estoppel is still available to trademark licensors. *Seven-Up Bottling Co. v. Seven-Up Co.* 561 F.2d 1275, 1279 (8th Cir. 1977) ("Under the doctrine of licensee estoppel a plaintiff-licensee is estopped from contesting the validity of its licensor's marks"). It appears that trademark consent judgments and settlement agreements are equally immune from the *Lear* doctrine. For example, the Sixth Circuit distinguished *Lear* and held that a defendant who had entered into an agreement with a trademark owner

to stop use and recognize the validity of the mark could not contest the validity of the mark. *Beer Nuts, Inc. v. King Nut Co.*, 477 F.2d 326 (6th Cir. 1973). *Accord Danskin, Inc. v. Dan River, Inc.*, 498 F.2d 1386 (C.C.P.A. 1974) (holding settlement agreement signator estopped from opposing a registration, and distinguishing *Lear*).

D. IP DISPUTES GENERALLY

If a license is granted as part of a an IP settlement dispute, the parties should specify under what circumstances, if any, the validity of the IP may be questioned. Unless it is clear from the face of the consent judgment or settlement agreement, issue preclusion will likely not apply.

III. STANDING TO SUE

A plaintiff asserting a patent infringement claim should be certain that it has a right to sue. Absent standing to sue when the lawsuit is initiated, a federal district court has no jurisdiction to entertain the dispute. In *Enzo APA & Son, Inc. v. Geapag A.G.*, 134 F.3d 1090 (Fed. Cir. 1998), the court held that a post-filing cure of a standing defect ineffective and the case was properly dismissed.

In that case, Enzo and others filed an action seeking a declaratory judgment of patent invalidity and non-infringement. Geapag and Nueva Farma separately sued Enzo for patent infringement. Those cases were subsequently consolidated. Geapag was granted a partial summary judgment that it had standing at the time the suit was filed. *Id.* at 1092.

On appeal, the Federal Circuit reversed the standing issue, noting that prior to the date when Enzo filed its declaratory judgment action, Geapag had an exclusive sublicense that did not include the patent-in-suit. After the two lawsuits were filed, Geapag acquired an exclusive license to the patent-in-suit that was expressly made

retroactive to December 1992 – before the lawsuits were filed. Both parties to the agreement indicated that it merely reflected the oral agreement that they had entered into in December 1992.

In finding no standing to sue, the Federal Circuit rejected the argument that because Geapag obtained its rights under a license agreement, the agreement did not have to be in writing. *Id.* at 1093. The Federal Circuit described an exclusive licensee as a "virtual assignee" and concluded that a written agreement was necessary. The Federal Circuit also rejected Geapag's argument that its *nunc pro tunc* agreement was sufficient to confer standing. *Id.*

In view of *Enzo,* exclusive licensees should ensure that the agreement granting those rights is in a writing executed before a suit for patent infringement is filed.

Another standing issue is raised when there are co-owners of a patent who are not agreed on suing an infringer. In *Ethicon, Inc. v. U.S. Surgical Corp.*, 135 F.3d 1456 (Fed. Cir. 1998), Ethicon, the exclusive licensee sued U.S. Surgical for patent infringement. U.S. Surgical identified an unnamed co-inventor, obtained a license from him and sought to correct inventorship of the patent. The Court concluded that the unnamed inventor should have been added to the patent and dismissed Ethicon's infringement lawsuit because the unnamed co-inventor had not consented to the lawsuit. *Id.* at 1468.

The curious aspect of *Ethicon* is that while the Federal Circuit observed that the unnamed co-inventor could not grant a retroactive license that would effectively result in a release for past infringement, the court's ultimate decision resulted in such a release.

In *H.R. Techs., Inc. v. Astechnologies, Inc.,* 275 F. 3d 1378 (Fed. Cir. 2002), the Federal Circuit considered whether a district court abused its discretion in dismissing a plaintiff's claims for patent infringement without prejudice, as opposed to with prejudice, based on

“reasoning that HRT [the plaintiff] had been unaware that its filing was premature.” *Id.* at 1385. A dismissal without prejudice would allow HRT to correct its standing defect and bring further litigation against the same defendant. To determine whether the dismissal should have been with prejudice, the Federal Circuit applied the procedural law of the Sixth Circuit. Since “under Sixth Circuit law, the decision whether to dismiss with or without prejudice is committed to the sound discretion of the district court,” and there was no such abuse, the Federal Circuit affirmed the finding of dismissal without prejudice. *Id.* at 1384.

In view of this, the licensee who wishes to correct its standing and bring further suit should realize that the availability of a dismissal without prejudice depends on the law of the pertinent regional circuit.

IV. ATTORNEY-CLIENT PRIVILEGE

Patent owners and their exclusive licensees frequently communicate about pending patent applications and other related legal topics. To enhance the likelihood of preserving the privileged status of those communications, the parties should consider entering into an agreement that recognizes their common legal interest and requires that they maintain the confidentiality of all protectable communications.[2] Not every “common interest” qualifies, however, and the failure to understand this may result in forced disclosure of what the parties considered to be immunized communications. *See In re Regents of the University of California*, 101 F.3d 1386 (Fed. Cir. 1996).

In that case, the Federal Circuit held that the University of California (“UC”) had the requisite common interest with its optionee/licensee, Eli Lilly, such that the attorney-client

[2] Counsel should clearly indicate in writing who is and who is not the client

privilege applied to communications between UC and attorneys for Lilly. *Id.* at 1391. After UC filed a patent application that led to the patent-in suit, it entered into an exclusive option agreement with Lilly for a license to rights to the U.S. patent and foreign counterparts. Upon certain conditions subsequent, the license would, and ultimately did, become exclusive. *Id.* at 1388-89. Lilly's in-house lawyers became responsible for prosecuting the foreign counterpart applications and in doing so collaborated with UC's patent counsel.

A dispute arose over the protectability of communications between Lilly's attorneys and UC concerning UC's patent applications. Genentech sought to depose three in-house Lilly lawyers relating to the U.S. and foreign prosecution of UC's patent. *Id.* at 1388. Even though the trial court concluded that communications between Lilly's lawyers and UC were not privileged because their legal interests were not identical, it stayed the discovery. UC then petitioned for mandamus, and the Federal Circuit granted the writ. *Id.*

Genentech argued that the UC and Lilly lawyers frequently discussed certain prior art material to the patent-in-suit. Genentech argued that the communications were relevant to the inequitable conduct issue. Genentech also sought the communications between UC and Lilly's lawyers concerning errors in the patent-in-suit that ultimately led to a Certificate of Correction, which Genentech contended was obtained by inequitable conduct. *Id.* at 1389.

Genentech took the position that the communications between UC and Lilly were not privileged because Lilly was a third party. UC argued that the Lilly lawyers represented both UC and Lilly in an effort to obtain the patent rights in question. Their communications, UC argued, were therefore protected by the attorney-client privilege. *In re Regents of the University of California*, 101 F.3d at 1389. The Federal Circuit accepted that the Seventh Circuit's standard for

"common legal interest" was narrowly drawn, and concluded that the legal interest between UC and Lilly was "substantially identical because of the potentially and ultimately exclusive nature of the UC-Lilly license agreement." *Id.* at 1390.

In the case of *In re Spaldig Sports Worldwide, Inc.*, 203 F.3d 800 (Fed. Cir. 2000), the Federal Circuit considered "the applicability of the attorney-client privilege to the invention record submitted to Spalding's corporate legal department" by the two inventors. *Id.* at 802. Since this issue pertained to patent law, the Federal Circuit choose to apply its own law to the question of whether the communication was privileged. *Id.* at 803. The court stated that under its law, "the central inquiry is whether the communication is one that was made by a client to an attorney for the purpose of obtaining legal advise or services." *Id.* at 805. It noted that Spalding's patent counsel would "refer to the invention record for the purpose of making patentability determinations," and that "the preparation and prosecution of patent applications constitutes the practice of law." *Id.* at 805-806. The court then held "that an invention record constitutes a privileged communication, as long as it is provided to an attorney 'for the purpose of securing primarily legal opinion, or legal services, or assistance in a legal proceeding'." *Id.* at 805 (quoting *Knogo Corp. v. United States*, 213 U.S.P.Q. (BNA) 936, 940 (Ct. Cl. Trial Div. 1980)).

In view of this, a licensee should realize that: (1) an attorney-client communication that pertains to patent law will only be privileged if it is "for the purpose of securing legal services," and (2) communications such as invention records are privileged if they are made for "the preparation and prosecution of patent applications."

In the case of *In re Toy*, 102 Fed. Appx. 657 (Fed. Cir. 2004) (nonprecedential opinion), plaintiff William Toy

sued several defendants for infringement of a patent. William's Father, Frank Toy, had previously retained an attorney to prepare the patent application. The defendants sought those communications that were solely between that attorney and William, on the ground that they were unprotected because William Toy was not a client of the attorney. The District Court of New Jersey granted discovery of these materials under the Third Circuit's standard for "common legal interest." When the plaintiff petitioned, the Federal Circuit denied a writ of mandamus that would have directed the district court to protect these materials on the grounds of attorney-client privilege. The Federal Circuit found that William, despite demonstrating the existence of a familial relationship, "did not establish a sufficient common interest solely between William Toy and Frank Toy as son and father," and thus "has not met his burden to obtain mandamus relief." ***Id.*** **at 658.**

In view of this case, parties should realize that in the absence of an optionee/licensee relationship, the Federal Circuit finds a narrowly drawn standard for "common interest" to be acceptable. While the case ***In re Toy*** **is nonprecedential, and thus may not be cited as precedent under Federal Circuit Rule 47.6(b)[3], it is nonetheless instructional and should guide counsel.**

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[3] **Federal Circuit Rule 47.6(b) reads as follows:**

> **(b) Nonprecedential Opinion or Order. An opinion or order which is designated as not to be cited as precedent is one determined by the panel issuing it as not adding significantly to the body of law. Any opinion or order so designated must not be employed or cited as precedent. This rule does not preclude assertion of claim preclusion, issue preclusion, judicial estoppel, law of the case, or the like based on a decision of the court designated as nonprecedential..**

V. IP AUDITS

An IP audit should be performed as a matter of course before efforts begin to license IP rights. That way any fatally-flawed rights can be removed from the pool for licensing, and appropriate remedial action, such as reissue or reexamination, can be undertaken. This pre-licensing investigation can remove many concerns that a potential licensee could raise in an effort to induce concessions from the owner of the IP rights.

There is another compelling reason why an audit should be performed prior to offering a license. After an IP license agreement is executed and when a third party is identified as a potential infringer of the licensed property right, a great deal of pressure can be placed on the licensor to enforce the licensed rights. While the licensor is obligated to investigate relevant matters – at the very least to satisfy Rule 11, Fed. R. Civ. P. – pressure will be placed on the licensor to bring suit against the alleged infringer immediately.

There is no doubt that under those circumstances it may be difficult to perform a proper investigation. Instead of leaving all of the due diligence to be conducted after the license is executed and an infringer is located, however, it makes more sense to conduct an IP audit before licensing the intellectual property right. This is particularly true considering that the enforcement of a patent obtained by fraud on the United States Patent and Trademark Office may violate § 2 of the Sherman Act if all of the other elements necessary to establish a § 2 violation are established. *Walker Process Equip., Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965). An objectively baseless lawsuit to enforce invalid IP rights may also be found to violate the Sherman Act. *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 60-61 (1993); *CVD, Inc. vs. Raytheon Co.*, 769 F.2d 842, pinpoint (1st Cir.

1985); *Handgards, Inc. v. Ethicon, Inc.*, 743 F.2d 1282, 1289 (9th Cir. 1984).

In view of the stakes involved if a mistake is made and in order to avoid an unnecessary dispute with a licensee, it makes sense to perform an IP audit in order to identify flaws or imperfections in the property rights considered for licensing.

Many pre-licensing actions can be taken to remedy imperfections that may be found in patents or in titles to IP rights. At least the most significant flaws or issues should be known well before any licensing is undertaken. By the time litigation is considered, hence, the major flaws or issues will have been considered and any ill effects eliminated or reduced.

VI. PATENT EXHAUSTION ISSUES

The patent exhaustion doctrine is far too complicated to be given fair treatment in this paper.[4] Under this doctrine, a broad licensing agreement might preclude a patent owner from enforcing his rights against a third party's use or resale of products purchased from licensees. It is therefore important for a patent owner to realize the full implications of licensing a potential competitor.

For example, in *Cyrix Corp. v. Intel Corp.*, 803 F. Supp. 1200 (E.D. Tex. 1992) ("*Cyrix I*"), and *Cyrix Corp. v. Intel Corp.*, 846 F. Supp 522 (E.D. Tex. 1994) ("*Cyrix II*"), Intel entered into a 22 year cross-license agreement with the Mostek Corporation, the terms of which granted each party the right "to make, have made, to use, to sell (either directly or indirectly), to lease and to otherwise

[4] For an excellent treatment of the topic, see Amber Hatfield, *Patent Exhaustian, Implied Licenses, and Have-Made Rights: Gold Mines or Mine Fields?*, 2000 Comp. L. Rev. & Tech. J. 1 (2000).

dispose of Licensed Products." ***Cyrix I*** **at 1203. In addition, the agreement provided that the license could be assigned, without the other parity's consent, to a successor in ownership. At the time of the agreement, both parties were engaged in "foundry" work, which is when a semi-conductor company makes and sells products that were designed or developed by its customers.**

Eight years into the agreement, Mostek was obtained by SGS-Thomson, a company that engaged in "foundry" work for defendant Cyrix. As the assignee of the license agreement, SGS began to manufacture and sell products to Cyrix that read on Intel's patent. Cyrix had designed the product itself, and would purchase the product from SGS, add further components, and then re-sell the product. When Intel sued Cyrix for infringement, the Court read the broad license agreement to authorize the parties to act as a "foundry" for another company. Since an "authorized" sale exhausts the patent monopoly as to that product, Cyrix was free to use or resell the product free of interference from the patent owner. The Court thus held that Cyrix was entitled to a judgment of non-infringement based "on its affirmative defenses of patent exhaustion." ***Cyrix II*** **at 541.**

In view of this, parties should realize the consequences of entering into broad licenses. Under the patent exhaustion doctrine, broad licenses designed to create "patent peace" between parties may have the unexpected result of allowing third parties to form strategic alliances with licensees, and thus avoid the reach of patent infringement statutes.

VII. CONCLUSION

Before and during the licensing process, the parties should always consider the possible disputes that may arise well after the agreement is executed. The issues discussed in

this paper address some of the potential pitfalls that may be encountered post-execution. By treating this paper as a framework for pre-licensing considerations, a more successful agreement from a litigation perspective should follow.