Recent Developments in the Law Relating to Licensing

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A LICENSOR WHO AGREES TO USE "BEST EFFORTS" TO RECOVER AND LICENSE PATENT RIGHTS CAN AND MUST DO SO WHEN THOSE RIGHTS ARE OWNED BY A WHOLLY-OWNED SUBSIDIARY OF THE LICENSOR. THE CORPORATE VEIL MAY BE PIERCED TO PREVENT THE LICENSOR FROM SHIRKING THAT CONTRACTUAL OBLIGATION

In *Institut Pasteur v. Cambridge Biotech Corporation*, No. 98-1012 (Fed. Cir. July 7, 1999), the Federal Circuit affirmed a holding of the bankruptcy court and the district court that Cambridge was licensed under the patents in suit because PSD, a related company to the plaintiffs, breached a "best efforts" provision in a license agreement. The Federal Circuit also affirmed a royalty rate calculated by the bankruptcy court and addressed issues related to joinder of parties, right to jury trial, and jurisdiction to review a bankruptcy court's decision.

Institut Pasteur owns patents directed to the structural components of and methods of detecting HIV. These patents were involved in a complex web of licensing and cross-licensing agreements that led to the instant dispute. Institut Pasteur owned 26% of the stock of PSD, which in turn wholly owned SDP. Defendant, Cambridge manufactures and sells diagnostic kits for detecting the presence of HIV and eventually filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code.

In 1989, Cambridge and PSD entered into a cross-licensing agreement concerning the patents. PSD had obtained an exclusive license under the patents, with the right to sublicense, from Institut Pasteur, the owner of the patents. PSD in turn exclusively licensed the patents to Genetic Systems pursuant to a 1994 joint venture agreement. Accordingly, at the time the 1989 Agreement was signed, PSD had no right to grant licenses under the patents. PSD did agree, however, to use "best efforts" to recover its right to sublicense those patents from Genetic Systems. SDP later acquired Genetic Systems, but did not recover those rights.

Institut Pasteur sued Cambridge in 1995 in the United States Bankrupty Court for infringement of the patents, seeking damages and an injunction. In its defense, Cambridge argued, among other things, that it had a license to practice the inventions claimed in the patents or, alternatively, that Institut Pasteur, by way of PSD had broached the "best efforts" provision of the 1989 Agreement by failing to acquire the rights to these patents from Genetic Systems and were estopped from bringing suit.

The bankruptcy court rejected Cambridge's argument that by acquiring all of the stock of Genetic Systems, SDP had recovered the right to grant sublicenses, noting that possession of the right to grant sublicenses and ownership of a company that possesses those rights are not the same thing. Accordingly, the court refused to declare that Cambridge was licensed under the patents on that basis. The court, however, determined that PSD had failed to make any effort, let alone its "best efforts," to recover the patents rights even after it purchased Genetic Systems, and that "best efforts" required at least some effort. As a result of the breach of the "best efforts" clause, the bankruptcy court declared the patents to be licensed patents.

On appeal, the Federal Circuit agreed that PSD had made no real effort to recover the rights at issue and thereby breached the "best efforts" clause of the agreement. The court also held that the bankruptcy court did not abuse its discretion by ignoring the separate corporate structure of Genetic Systems and PSD and declaring that the patents were licensed patents. The Federal Circuit noted that the corporate veil may be pierced to achieve equity and that in this case it would be inequitable to allow PSD to shirk its contructual obligation by hiding behind Genetic Systems, a wholly owned subsidiary, rather than satisfying its best efforts obligation by directing Genetic Systems to transfer the right to operate under the patents.

ACCEPTABLE NONINFRINGING USES OF A DEVICE FOR PURPOSE OF PREVENTING AN IMPLIED LICENSE TO A PATENTED METHOD NEED NOT BE AS PROFITABLE AS THE PATENTED METHOD BUT NEED ONLY BE REASONABLE

Parties attempting to show that they have an implied license to practice a patented method based on the sale of device by the patentee or its licensee must show that there are no acceptable noninfringing uses for the device. An acceptable noninfringing use need only be reasonable and need not be as profitable as the patented methods.

Glass Equipment Development, Inc. v. Besten, Inc., No. 96-1467 (Fed. Cir. Apr. 5, 1999), reversed the district court's grant of summary judgment and concluded that Besten was liable for inducing Simonton to infringe GED's method and patent because Simonton did not have an implied license under the patent in suit.

GED owns an apparatus patent covering spacer frame assemblies for thermally insulating glass windows and a method patent covering methods for making spacer frame assemblies using a linear extruding machine. GED had licensed the apparatus patent to Allmetal to make various spacer frame components. Simonton, a manufacturer of insulated glass windows, bought these components from Allmetal and made spacer frames.

In 1988, Simonton purchased a linear extruding machine from Besten and used it for making spacer frames. In 1993, GED sued Simonton for infringement of the method patent and Besten for inducing infringement. Simonton eventually settled with GED and was not a party to the appeal. Besten defended the suit brought by GED by arguing that Simonton had an implied license to practice the claimed method because there were no noninfringing methods of using the components bought from GED's licensee, Allmetal.

The district court agreed that Simonton had an implied license to practice the method claimed in the method patent, concluding that there were no "commercially viable" noninfringing uses because the patented method was the most profitable manufacturing method of using components sold by Allmetal as of the time of the summary judgment hearing. The district court stated that while noninfringing uses of the components had been made years before, by the time of the hearing, those uses were no longer made commercially because a business using the noninfringing methods would be undersold by a business using the patented method. Because Besten, therefore, could not be liable for inducing Simonton to infringe, the district granted summary judgment in favor of Besten.

The Federal Circuit reversed, holding that the district court had improperly limited its analysis of the existence of noninfringing uses to the time of the final summary judgment hearing and had used an overly restrictive profitability or commercial viability requirement in assessing noninfringing uses. The time frame should not have been so limited, especially where Besten had made no showing that changes in the insulated window business that were related to commercial implementation of the patented method had caused the previously used noninfringing uses to become unreasonable for all insulated window manufacturers. The Court reiterated that a legally acceptable noninfringing use need not be as profitable as the patented method, it need only be reasonable. Since Besten had not met its burden of showing an absence of acceptable noninfringing methods,

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the Court held that Simonton did not have an implied license to practice the invention claimed in the method patent and reversed the grant of summary judgment.

AN ENFORCEABLE VERBAL LICENSE AGREEMENT WAS EVIDENCED BY A LETTER SPECIFIYING THE TERMS OF THE PROPOSED OF AGREEMENT INCLUDING AMOUNT AND TIMING OF ROYALTY PAYMENTS AND BY DEVELOPMENT AND DELIVERY OF LICENSED PRODUCT

The Parties entered into an enforceable verbal license agreement when the defendant offered orally, and then in a letter, to pay royalties in exchange for the use of new formulations that the plaintiff develops and the plaintiff accepted by performing research, testing, and development of new formulations thereby acting in a manner manifesting his intent to be bound by the licensing agreement.

In *Naimie v. Cytozyme Laboratories, Inc.*, Nos 97-4129, 97-4147 (10th Cir. April 8, 1999), the Tenth Circuit affirmed the district court's finding that the parties had entered into a valid and enforceable verbal license agreement, and that a later written consulting agreement entered into by the parties was not an integrated contract and did not supersede or cancel the verbal agreement because the written agreement incorporated and referenced the earlier license agreement.

Cytozyme, a manufacturer of plant and animal growth enhancement products, approached plaintiff Dr. Naimie to see if he would be interested in developing new product formulations for Cytozyme products. After initial discussions, Cytozyme confirmed its offer to pay royalties in exchange for the transfer of "a new technology base" to be developed by Dr. Naimie by way of letter dated January 1981. Dr. Naimie then began developing new formulations. In another letter dated September 28, 1981, to Dr. Naimie, Cytozyme again confirmed that it "is our agreement to pay you an override . . .on completed products that we produced using the technology that you have developed for Cytozyme." Shortly thereafter, Dr. Naimie delivered his first formulation to Cytozyme.

About a month later, in October 1981, the parties entered into a written Agreement (the October 1981 Agreement), which stated that "[i]n order to protect [Dr. Naimie's] interest in the products developed in the past or which may be developed by [Dr. Naimie] in the future, [Cytozyme] agrees to pay to [Dr. Naimie] a royalty pursuant to the attached schedule." Four years later, on May 28, 1995, the parties entered into another agreement (the May 1985 Agreement). In that agreement, Cytozyme agreed to hire Dr. Naimie as a consultant for an annual fee. The agreement also provided that in addition to this fee, Dr. Naimie "will, as in the past be entitled to royalties on products [he has] developed or will develop."

Five years later Cytozyme terminated the May 1985 Agreement and stopped making royalty payments after July 1990. Dr. Naimie, by letter dated May 6, 1991, terminated Cytozyme's license to use the formulations. When Cytozyme continued to manufacture products containing Dr. Naimie's formulations, he filed suit.

The district court concluded that the parties had entered into a verbal licensing agreement on or about September 1981 and a written consulting agreement. The Tenth circuit agreed.

At the start, the Tenth Circuit rejected the argument that the award of damages to Dr. Naimie conflicted with federal patent law. Cytozyme had argued that Dr. Naimie could only own an invention through a federal patent and that the court's findings regarding ownership the formulations created state patent rights, which had been prohibited by the Supreme Court in *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141 (1989). The Tenth Circuit noted that states could adopt rules "for the promotion of intellectual creation within their own jurisdiction" as long as those rules did not impermissibly interfere with the federal patent scheme. The Tenth Circuit held that enforcement of the freely undertaken contract between Dr. Naimie and Cytozyme did not frustrate federal patent laws. It noted that enforement of the contract (1) encouraged invention because the royalties provide an additional incentive to invention; (2) did not conflict with federal policy of disclosure because manufacture of Cytozyme's products did not automatically lead to full disclosure; (3) encouraged the exploitation of an invention that might have otherwise remained undeveloped; (4) did not prevent others from discovering the formulations, and (5) did not withdraw ideas from the public domain because the formulations were not in the public domain before Cytozyme obtained its license.

The Court agreed with the district court that a verbal license agreement arose about September 1981, because the parties had agreed to all of the essential terms of a licensing agreement by that time. The Court first noted that Cytozyme clearly made an offer both orally and in writing that contained all of the terms of the proposed agreement including the amount and timing of the royalty payments. The Court further noted that Cytozyme confirmed its agreement to pay Dr. Naimie royalties in another letter and that Dr. Naimie responded to these offers by performing research, developing new formulations, and delivering his first formulation by September 1981. The Court concluded that Dr. Naimie acted in a manner manifesting his intent to be bound by the license agreement.

The Tenth Circuit also agreed with the district court that the May 1985 Agreement was not an integrated contract such that it would superside prior agreements. The Court noted that the Agreement mostly related to Dr. Naimie's full-time consulting duties and only mentioned royalites in passing. In addition, the Court noted that both parties had testified that the primary purpose of the May 1985 Agreement was to make Dr. Naimie a consultant.