Recent Decisions In The United States

A recurring feature
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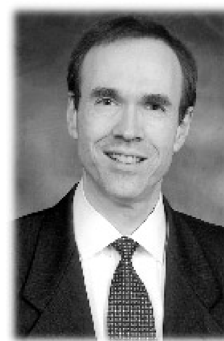
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OFFER TO ENTER INTO A LICENSE FOR FUTURE SALE OF AN INVENTION IS NOT AN OFFER TO SELL THE INVENTION AND DOES NOT INVALIDATE A PATENT ON A SUBSEQUENTLY FILED PATENT APPLICATION

A U.S. patent is invalid if the claimed invention was offered for sale more than one year prior to filing the patent application. However, understanding what constitutes an offer to sell the invention requires an analysis of the subject matter of the offer and whether it is an offer to sell the patent rights to the invention or sell the product covered by the patent claims.

In Elan Corp., *PLC v. Andrx Pharmaceuticals, Inc*., Nos. 03-1354, 03-1355, 03-1386, 03-1387 (Fed. Cir. May 5, 2004), the United States Court of Appeals for the Federal Circuit held that an offer to enter into a license under a patent for the future sale of the invention when and if it has been developed is not an offer to sell the invention.

This case involved patent infringement allegations over a controlled-release anti-inflammatory drug, naproxen. In the 1980s, Elan Corp. ("Elan") began work on a controlled-release naproxen formulation, for which it later received a patent. In 1987, Elan sent letters to various companies concerning its controlled-release naproxen formulation. The letters offered a license for the development and sale of Elan's controlled-release naproxen formulation. In addition to providing the terms for a license, the letter also indicated that Elan would supply naproxen tablets at a price structure allowing for an initial gross margin of not less than 70% based on current naproxen prices.

In this case, Elan sued Andrx Pharmaceuticals ("Andrx") for infringement of its patent directed to its controlled-release naproxen formulation. Andrx defended by arguing that the claims of Elan's patent were invalid under the on-sale bar of § 102(b) due to the letters it sent offering to supply the formulation to various companies. Under § 102(b), a claim of a patent is invalid if the claimed invention was offered for sale more than one year prior to the filing of the application containing that claimed invention. In this case, Elan's original patent application was not filed until 1990, therefore, the court had to decide whether those letters constituted an "offer for sale." The District Court held that they did, and therefore found the claims of the patent invalid.

On appeal, the Federal Circuit disagreed with the District Court's conclusion. The court first explained that in order for an offer to constitute an "offer to sell" under § 102(b), the offer must rise to the level of a commercial offer for sale, which the other party could make into a binding contract by simple acceptance. The court went on to explain that an offer to sell the rights in a patent or an offer to license a patent is distinct from an offer to sell a product that embodies the invention claimed in the patent. The former will not invalidate the claims of a patent under § 102(b), while the latter will. Based on these principles, the court found that Elan's letters did not constitute an "offer for sale."

The Federal Circuit found that the letters were an offer to enter into a license under the patent for a future sale of the invention when and if it was developed. The letters were not offering to sell naproxen tablets, but rather granting a license under the patents and offering an opportunity to become a partner in testing and marketing of the tablets at some indefinite point in the future. In addition, the letter lacked definite sales terms that would indicate that this was a commercial offer, such as quantities, time of delivery, place of delivery, or product specifications. Finally, the court found that the gross profit margin figure discussed in the letter did not constitute a price term because at the time of the letter there was no way to determine what would be the proper price for naproxen tablets.

COURT, NOT ARBITRATOR, MUST DETERMINE QUESTIONS RELATED TO THE EXISTENCE OF AN ARBITRATION AGREEMENT

In *Microchip Technology Inc. v. U.S. Philips Corp*. et al., No. 03-1478 (Fed. Cir. May 13, 2004), the United States Court of Appeals for the Federal Circuit considered whether a district court was obligated to refer questions related to the existence of an arbitration agreement to arbitration. The Court found that it was not so obligated, and that the district court itself could decide the questions.

This case involved alleged infringement of a patent owned by Philips related to electronic circuits. Philips accused Microchip Technology ("Microchip") of infringing

its patent and Microchip defended by arguing that it was licensed. The license dispute grew out of an earlier agreement between Philips and General Instrument Corporation ("GI"). This agreement granted GI a non-exclusive license to several of Philips' patents. Microchip claimed to be a successor to the agreement because it was spun off from a wholly owned subsidiary of GI.

The agreement included an arbitration clause that provided that "all disputes arising out of or in connection with the interpretation or execution of this Agreement" would be resolved by arbitration. Philips attempted to commence an arbitration to resolve the license dispute, but Microchip refused to arbitrate. Philips then filed a Motion to Compel Arbitration. The District Court denied this motion because, in its view, the court needed to first determine whether Microchip was a party to the agreement before it could determine whether or not to enforce the arbitration clause.

On appeal, the Federal Circuit held that the district court was not obligated to refer to arbitration questions related to the existence of an arbitration agreement between Philips and Microchip. Under Supreme Court precedent, the question of whether a party is bound by an arbitration provision is a "threshold question" for the court to decide. Since a party "cannot be compelled to arbitrate if an arbitration clause does not bind it …a compulsory submission to arbitration cannot precede judicial determination that the …agreement does in fact create such a duty." In the present case, the issue of whether Microchip was a successor to the agreement was a threshold issue that required determination before the dispute could be submitted to arbitration. Therefore, the Federal Circuit affirmed the decision of the District Court.

Microchip also argued that the arbitration agreement had expired because the agreement contained a provision that the agreement itself would expire in 1987 with the exception of certain provisions. Since the arbitration clause was not one of the excepted provisions, Microchip argued that it had expired. The Federal Circuit, first held that the question of whether the arbitration agreement had expired was one for the court and not the arbitrator. The court further found that the arbitration clause survived expiration of the agreement's other provisions due to the unambiguous language of the clause, which provided that "all disputes arising out of or in connection with the interpretation or execution of this Agreement during its life or thereafter" were subject to arbitration. Therefore, the Federal Circuit rejected Microchip's argument.

RELEASE IN SETTLEMENT AGREEMENT DID NOT PRECLUDE LATER INFRINGEMENT ACTION ON A DIFFERENT PATENT

Releases of liability in settlement agreements can be drafted narrowly to cover the matter in controversy or more broadly to cover related matters as well. In *Diversified Dynamics Corp. v. Wagner Spray Tech Corp.*, No. 03-1495 (Fed. Cir. July 8, 2004), the United States Court of Appeals for the Federal Circuit held that the release language in a settlement agreement it reviewed should not be construed to preclude a later infringement action on a different patent.

The patents of interest cover paint application products. In 1999, Diversified sued Wagner for infringement of U.S. Patent No. 4,695,176 ("the '176 patent") relating to a flow control valve for paint application products. The parties entered into a settlement agreement that included a release. The release stated that Diversified would not sue Wagner for "any and all actions . . . arising out of or in any way relating to the '176 patent." In 2003, Diversified sued Wagner for infringement of a different patent, U.S. Patent No. 4,810,123 ("the '123 patent"). The '123 patent, however, also relates to a flow control valve.

In the District Court, Wagner argued that the release barred Diversified's claim for infringement under the '123 patent. The District Court concluded that the '123 patent was related to the '176 patent, noting that in the prosecution file the patentees admitted that the '123 patent is related to and a companion to the '176 patent, and that the two patents had similarities in drawings and text. Based on the relationship of the two patents, the District Court granted summary judgment in favor of Wagner holding that the release barred Diversified's cause of action under the '123 patent.

On appeal, the Federal Circuit held that the release did not bar Diversified's claim. The court found that the release was unambiguous and required a narrow construction. The Federal Circuit held that the language of the release required a relationship between the action under the '123 patent and the '176 patent itself. Therefore, the issue was "whether [the] action is related to the '176 patent, not whether the '176 patent is related to the action." According to the language of the release the focus is on "the connection between the action and the '176 patent, not the connection between a patent and the '176 patent." Based on this interpretation, the court found that the action related only to the '123 patent because the technology claimed to be infringed was only claimed in the '123 patent. Therefore, the release did not bar this claim.

The Federal Circuit also noted that the District Court erred by focusing its analysis on the relatedness of the '123 patent to the '176 patent. The issue was whether or not Diversified's new infringement action was related to the '176 patent, not whether the '123 patent was related to the '176 patent. Thus, the fact that the patents may be related was not relevant to the analysis. Therefore, the Federal Circuit reversed the District Court's holding.

RETAILER IS ASSESSED ROYALTY HIGHER THAN PROFIT MARGIN AND FOUND TO WILLFULLY INFRINGE BY UNREASONABLY RELYING ON SUPPLIER'S SIMPLE ASSURANCE THAT PRODUCT DOES NOT INFRINGE WHILE CONTINUING TO SELL ACCUSED PRODUCT

Failure to establish a reasonable belief of non-infringement after having received notice of infringement and continuing the accused activity constitutes willful infringement and can result in punitive damages trebling liability.

In *Golight, Inc. v. Wal-Mart Stores, Inc*., No. 02-1495 (Fed. Cir. January 20, 2004), the United States Court of Appeals for the Federal Circuit held that a retailer failed to take appropriate action after receiving a cease and desist letter and affirmed a finding of willful infringement.

This case involved patent infringement allegations over a wireless, remote-controlled, portable search light for which Golight owned a patent. In 1997, Wal-Mart, began selling a portable search light, which was allegedly a low-end copy of the device developed by Golight. After learning of Wal-Mart's sales, Golight's counsel sent a letter to Wal-Mart informing it of the alleged infringement, and subsequently, Golight sued Wal-Mart for patent infringement.

The District Court found that Golight's patent was valid and infringed, awarded Golight a reasonable royalty greater than Wal-Mart's profits, found Wal-Mart's infringement to be willful, and awarded Golight its attorney's fees.

On appeal, the Federal Circuit affirmed the findings of the District Court as to validity and infringement. The court also affirmed the reasonable royalty awarded by the District Court. The Federal Circuit noted that there is no rule requiring that a royalty be no higher than the infringer's profit margin or that the award cannot leave the infringer selling the product below cost. In fact, in this case Wal-Mart was already selling the products at a loss, even before damages were awarded. Moreover, the only evidence put forth by Wal-Mart was the testimony of a store manager who indicated the types of royalties the store would ordinarily be willing to pay. The Federal Circuit found that this showed nothing more than what Wal-Mart might have preferred to pay, which was not the test for damages, and therefore upheld the reasonable royalty award.

The Federal Circuit also affirmed the District Court's willfulness finding. The court found that there was no admissible evidence that Wal-Mart took appropriate action after receiving the cease and desist letter from Golight. Wal-Mart argued that it had received a letter from the manufacturer of the products assuring that the products did not infringe. The letter, however, was not admitted into evidence at trial and was rejected by the District Court as "crudely drafted" and "cursory." Therefore, the Federal Circuit concluded that the finding of willful infringement was not clearly erroneous.

LIQUIDATED DAMAGES CLAUSE WITH HIGH MULTIPLIER IS FOUND UNENFORCEABLE

Agreements sometimes use a "liquidated damages clause" to specify the amount of damages due if the agreement is breached. Courts can find such clauses unenforceable if they are unreasonable. In *Monsanto Co. v. McFarling*, Nos. 03-1177, 03-1228 (Fed. Cir. April 9, 2004), the United States Court of Appeals for the Federal Circuit reviewed a liquidated damages clause in a technology agreement and held that it was unenforceable.

This case involved a technology agreement entered into between Monsanto and McFarling relating to genetically modified seeds. Monsanto holds several patents on genetically modified seeds and grants licenses to seed manufacturers to make seeds covered by those patents. Monsanto also requires that the seed manufacturers execute licenses with its farmer customers that require the farmers to use the seeds only for a single season and to not save or reuse the seeds generated by their crops. The technology agreement also includes a liquidated damages provision that provides for damages of 120 times the applicable Technology fee under the agreement in the case of a breach.

McFarling entered into a technology agreement in 1998. McFarling saved and reused a large number of the seeds generated by his crops. In 2000, Monsanto sued McFarling for patent infringement and breach of the technology agreement. In response, McFarling raised the defense of patent misuse and counterclaimed for antitrust violations. McFarling also argued that the liquidated damages clause was unenforceable. The District Court rejected McFarling's defense and counterclaim and found that McFarling had infringed Monsanto's patents and breached the technology agreement. The District Court further found the liquidated damages clause was valid and enforceable.

On appeal, the Federal Circuit affirmed the District Court's rejection of McFarling's patent misuse defense and antitrust counterclaim. The court, however, disagreed with the District Court regarding the liquidated damages clause. The court first ruled that Missouri law governed the interpretation of the agreement. Under Missouri law, for a liquidated damages clause to be valid, the amount of damages must be a reasonable forecast for the harm caused by the breach and the harm must be difficult to accurately estimate. In order to determine if the liquidated damages clause provides a reasonable estimate of the anticipated harm, the Missouri courts apply the "anti-one-size rule." This rule provides that a liquidated damages clause will be unenforceable when it applies the same measure of damages for different types of breaches, some of which are of an uncertain nature and others certain.

The Federal Circuit held that the 120 multiplier of the technology agreement was not a reasonable estimate of the harm that Monsanto would suffer upon breach of the agreement by McFarling. Specifically, the 120 multiplier violated the anti-one-size rule because the same provision applied to breaches of provisions relating to different crops and the damages caused for each different crop would necessarily be different. In addition, the provision also violated the rule because it applied the same damages regardless of how the agreement was breached. For example, if a farmer simply saved the seeds or saved and replanted the seeds the liquidated damages would be the same. Therefore, the Federal Circuit held that the liquidated damages clause was unenforceable and remanded the case for a determination of actual damages.