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# Covenant Not to Sue and Patent License: Two Sides of the Same Coin?



Contractual Exploitation of Patents Under U.S. Law



# Definitions



## **Covenant not to sue (CNS):**

- A binding promise not to sue another party for infringement of a patent

## **License:**

- A grant of permission to practice the patent

# Exclusionary Right



## 35 U.S.C. § 154

- “Every patent shall . . . contain a grant to the patentee, his heirs or assigns, **of the right to exclude others** for making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States . . . .”

# License is “Nothing More” than a CNS

“. . . a patent license agreement is in essence nothing more than a promise by the licensor not to sue the licensee.

Even if couched in terms of ‘[l]icensee is given the right to make, use, or sell X,’ the agreement cannot convey that absolute right because not even the patentee of X is given that right. His right is merely one to exclude others from making, using or selling X. Indeed, the patentee of X and his licensee, when making, using, or selling X, can be subject to suit under other patents.

In any event, patent license agreements can be written to convey different scopes of promises not to sue, e.g., a promise not to sue under a specific patent or, more broadly, a promise not to sue under any patent the licensor now has or may acquire in the future.”

*Spindelfabrik Suessen-Schurr, Stahlecker & Grill GmbH v. Schubert & Salzer Maschinenfabrik Aktiengesellschaft*, 829 F.2d 1075, 1081 (Fed. Cir. 1987) (citations omitted)

## License = Covenant Not to Sue

“The real question, then, is not whether an agreement is framed in terms of a ‘covenant not to sue’ or a ‘license’  
That difference is only one of form, not substance—both are properly viewed as ‘authorizations.’ Rather, the pertinent question here is not whether but what the [parties’] settlement agreement authorizes.”

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272, 1275 (2009)

## State or Federal Law?

Patent agreements involve the intersection of state and federal law.

- On the one hand, Patent licenses and CNS agreements are contracts, and thus, construed under state law (or foreign law if contracting abroad).

*Innovus Prime, LLC v. Panasonic Corp.*, No. C-12-00660-RMW, 2013 WL 3354390, at \*3 (N.D. Cal. July 2, 2013) (“The interpretation of contracts for rights under patents and patent licenses is ‘generally governed by state law.’”).

- On the other hand, the rights being conveyed are a matter of federal law
- Determining whether a covenant not to sue is a license is generally a matter of federal law

# Six Questions

1. Does a license have the same effect as a CNS when it comes to mooting a declaratory judgment action?
2. Can a covenant to a CNS transfer its benefit to a third party?
3. Is a CNS binding on a future patent owner?
4. Can a sale made by a covenantee exhaust the patent?
5. Can a CNS include an implied license to other patents not expressly included in the CNS?
6. Do bankruptcy protections exist for a covenantee?

## Question 1:

# Does Grant of License Moot Declaratory Judgment Jurisdiction? **No**

*MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007).

- A declaratory judgment action is available when there is a substantial controversy between the parties having adverse legal interests of sufficient immediacy and reality to warrant the issuance of a declaratory judgment
- Sufficiently immediate controversy existed where licensee filed declaratory judgment action against licensor



# Conditional/Unconditional



## Covenant not to sue

- typically unconditional

## License

- typically conditional
  - Subject to performance of conditions by the patentee, e.g. royalty payments

## Question 1:

# Does CNS Moot Declaratory Judgment Jurisdiction? **Yes**

An unconditional covenant not to sue to an alleged infringer can divest a court of declaratory judgment jurisdiction where it eliminates the case or controversy between the parties

- **Jurisdiction Divested:** “[A] covenant not to sue for patent infringement divests the trial court of subject matter jurisdiction over claims that the patent is invalid, because the covenant eliminates any case or controversy between the parties.” *Dow Jones & Co. v. Abblaise Ltd.*, 606 F.3d 1338, 1346 (Fed. Cir. 2010).
- **Content of Covenant:** “[W]hether a covenant not to sue will divest the trial court of jurisdiction depends on what is covered by the covenant.” *Revolution Eyewear, Inc. v. Aspex Eyewear, Inc.*, 556 F.3d 1294, 1297 (Fed. Cir. 2009).

## Question 1:

# Does CNS Moot Declaratory Judgment Jurisdiction? **Yes**

- *Already, LLC v. Nike, Inc.*, 133 S. Ct. 721 (2013).
  - A holder of intellectual property rights (in that case, a trademark) can end any case or controversy with a potential infringer of those rights by granting a unilateral covenant not to sue, and therefore, IP holder can divest the federal courts of subject matter jurisdiction over an invalidity challenge.

## Question 2:

# Is Non-Exclusive License Benefit Transferable?

**No**

A nonexclusive patent license implicitly prohibits sublicensing, unless there is express permission.

- Rights in a nonexclusive patent license are personal to the licensee.
- Rights may not be sublicensed unless the patent holder expressly grants the licensee permission to do so.

- *E.I. du Pont de Nemours & Co. v. Shell Oil Co.*, 498 A.2d 1108, 1113–14 (Del. 1985).

“[E]ven if a prohibition had not been written in the agreement, [licensee] would not have been permitted by operation of law to issue a sublicense. . . . [A] nonexclusive patent license carries with it an implied prohibition on sublicensing.”

- *In re CFLC, Inc.*, 89 F.3d 673, 679 (9th Cir. 1996).

“Federal law holds a nonexclusive patent license to be personal and nonassignable and therefore would excuse [licensee] from accepting performance from, or rendering it to, anyone other than [patent holder].”

## Question 2:

### Is Exclusive License Benefit Transferable? Yes

- Under an exclusive license, the patent holder generally transfers all indicia of ownership to the licensee and only retains the title to the patent.
- The licensee steps into the shoes of the patent owner and acquires the right to sublicense the patent and sue for patent infringement.

## Question 2:

### Is CNS Benefit Transferable? **No**

A covenant not to sue does not grant a transferable license.

- *Hilgraeve Corp. v. Symantec Corp.*, 265 F.3d 1336, 1346 (Fed. Cir. 2001).

“Symantec also contends that the covenant not to sue for patent infringement . . . is equivalent to a freely transferable license to the patent. This court has stated that ‘licenses are considered as nothing more than a promise by the licensor not to sue the licensee.’ . . . The covenant not to sue does not grant a transferable license to the patent.”

## Question 3:

# Is Obligation Binding on Future Patent Holder?

Yes

- “[A]ny person acquiring by assignment or license an interest in [a patent] takes title subject to prior assignments or licenses.”

*See Am. Dirigold Corp. v. Dirigold Metals Corp.*, 125 F.2d 446, 452 (6th Cir. 1942).

- A covenant not to sue is also binding on a future patent owner, whether or not the future patent holder has notice.

*Innovus Prime, LLC v. Panasonic Corp.*, No. C-12-00660-RMW, 2013 WL 3354390, at \*8 (N.D. Cal. July 2, 2013).

## Question 4:

# Can Sale Authorized By Licensee Exhaust the Patent? **Yes**

- Authorized unconditional sale of product exhausts patents rights embodied in product
    - “The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.”
    - If the licensee is authorized to sell the patented item, any downstream purchaser is protected from suit
- Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 621 (2008).



## Question 4:

# Can Sale By Covenantee Exhaust the Patent?

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272 (2009)

- As part of a settlement TransCore granted a CNS to Mark IV:
  - “In exchange for the payment set forth in paragraph 1,[TransCore] hereby agrees and **covenants not to bring any claim, demand, lawsuit or action against Mark IV for future infringement of any of [patents 1, 2, and 3]** or any foreign counterparts of the aforesaid United States Patents, for the entire remainder of the respective United States patents and their foreign counterparts. This Covenant shall not apply to any other patents issued as of the effective date of this Agreement or to be issued in the future.”
- Mark IV then sold its product to ETC
- TransCore accused ETC of infringing patents 1, 2, 3 recited in the CNS and patent 4 not recited in the covenant.

## Question 4:

# Can Sale By Covenantee Exhaust the Patent?

Yes

For patents 1, 2, and 3:

- When a patent holder grants a covenant not to sue that does not impose conditions on the right to sell products, the exhaustion doctrine precludes the grantor from bringing an infringement action against the covenantee's customers who purchased under an authorized sale.

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272, 1275 (2009).

## Question 5:

# Implied License and Legal Estoppel

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272, 1278 (2009).

What about patent 4, not recited in the CNS?

- “In exchange for the payment set forth in paragraph 1, [TransCore] hereby agrees and covenants not to bring any claim, demand, lawsuit or action against Mark IV for future infringement of any of [patents 1, 2, and 3] or any foreign counterparts of the aforesaid United States Patents, for the entire remainder of the respective United States patents and their foreign counterparts. **This Covenant shall not apply to any other patents issued as of the effective date of this Agreement or to be issued in the future.**”

## Question 5:

# Implied License and Legal Estoppel

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272, 1278 (2009).

What about patent 4?

- Patent 4 was broader than patents 1, 2, and 3 and thus necessary to practice the invention of those patents.
- The court found that CNS included an implied license under patent 4.
- Thus, the sale from Mark IV to ETC was authorized “under an **implied license** to practice that patent by virtue of legal estoppel”
- Accordingly, **TransCore was estopped** from asserting patent 4 “in derogation of the authorizations” to Mark IV to practice patents 1-3 recited in the CNS.

## Question 5:

# Can CNS Provide an Implied License to Practice Another Patent? **Yes**

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272, 1278 (2009)

- “The essence of legal estoppel that can be found in the estoppel of the implied license doctrine involves the fact that the licensor (or assignor) has licensed (or assigned) a definable property right **for valuable consideration, and then has attempted to derogate or detract from that right**. The grantor is **estopped** from taking back in any extent that for which he has already received consideration.”

*TransCore* citing *AMP Inc. v. United States*, 389 F.2d 448 (Ct. Cl. 1968)

## Question 6:

### Licensee Protections in Bankruptcy of Patent Holder

Section 365(n) of the bankruptcy code creates an exception for licensed IP rights that bars the trustee of an estate holding patent rights from unilaterally cancelling previously agreed-to licenses.

- If a trustee rejects a license, the licensee can treat the license as terminated, or retain its rights.

## Question 6:

# Does Covenantee Enjoy the Same Bankruptcy Protections? **Yes**

*In re Spansion, Inc.*, 507 F. App'x 125 (D. Del. 2011), *aff'd* 507 F. App'x 125 (3d Cir. 2012).

- Apple received CNS under Spansion patents as part of settlement agreement.
- Shortly thereafter, Spansion filed a voluntary bankruptcy petition and sought to reject the letter agreement as an executory contract.
- Third Circuit cited *De Forest Radio* and *TransCore* to hold that Apple could elect to retain its protection under § 365(n).

Right	Covenant Not to Sue	Non-Exclusive License	Exclusive License
General Definition	A binding promise not to sue on the patent	A non-exclusive grant of permission to practice the patent	An exclusive grant of permission proactive the patent
(1) Moot a Declaratory Judgment Action	Yes, unconditional CNS removes DJ jurisdiction	No, conditional license provides a defense to infringement, but may need to litigate for potential breach	No, conditional license provides a defense to infringement, but may need to litigate for potential breach
(2) Transferability of Benefit	No, the recipient of the CNS may not transfer the benefit to others	No, there is an implicit prohibition on sub-licensing to others if not specifically granted	Yes, the there is an implicit grant to sublicense if not otherwise excluded
(3) Binding on Future Patent Holder	Yes	Yes	Yes
(4) Patent Exhaustion	Yes, CNS generally authorizes sale by the covenantee, thus exhausting the patent for downstream customers	Yes, license authorizes sale by licensee, thus exhausting the patent for downstream customers	Yes, license authorizes sale by licensee, thus exhausting the patent for downstream customers
(5) Legal estoppel/implied license	Yes, CNS may include an implied license extending to other patents not expressly included in CNS	Yes, license may include implied license to other patents not expressly licensed	Yes, license may include implied license to other patents not expressly licensed
(6) Rights Protected in Bankruptcy of Patentee	Yes, a covenantee may generally retain its rights in a patent holder's bankruptcy	Yes, licensee may retain its rights in a patent holder's bankruptcy	Yes, licensee may retain its rights in a patent holder's bankruptcy



## License = Covenant Not to Sue

“The real question, then, is not whether an agreement is framed in terms of a ‘covenant not to sue’ or a ‘license’  
That difference is only one of form, not substance—both are properly viewed as ‘authorizations.’ Rather, the pertinent question here is not whether but what the [parties’] settlement agreement authorizes.”

*TransCore v. Elec. Transaction Consultants*, 563 F.3d 1272, 1275 (2009)



# Thank You

Thomas P Canty

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