

# ALLOWING PATENT VALIDITY CHALLENGES DESPITE NO-CHALLENGE CLAUSES: FULFILLING THE WILL OF KING *LEAR*

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## INTRODUCTION

In July 2013, Martha Stewart received a letter that would end up costing her media conglomerate millions of dollars.<sup>1</sup> In the letter, a company called Lodsys accused Stewart of marketing four iPad apps that infringed Lodsys' patent, and threatened Stewart with a costly patent infringement lawsuit.<sup>2</sup> Lodsys belongs to a category of companies commonly referred to as patent assertion entities (PAEs) because, in general, Lodsys does not intend to commercially use its iPad app patent but, instead, holds it primarily to sue others for infringement.<sup>3</sup> Lodsys demanded that Stewart's company, Martha Stewart Living Omnimedia, pay a patent licensing fee of \$5,000 per app.<sup>4</sup> This \$5,000 price tag was not derived randomly.<sup>5</sup> Rather, Lodsys deliberately set this price at an amount far lower than the average cost of defending a patent infringement suit in order to make the choice easy for Stewart.<sup>6</sup> Indeed, patent litigation is extremely expensive.<sup>7</sup> The average suit involving damages between \$1 million and \$25 million costs \$1.6 million through discovery and about \$2.8 million through trial.<sup>8</sup> Unfortunately for Lodsys, however, Stewart is not one to roll over and play dead. Instead, she

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1. Timothy B. Lee, *Patent Trolls Have a New Enemy: Martha Stewart*, WASH. POST (Sept. 26, 2013, 3:52 PM), <http://www.washingtonpost.com/blogs/the-switch/wp/2013/09/26/patent-trolls-have-a-new-enemy-martha-stewart/>.

2. *Id.*

3. Katherine E. White, *Preserving the Patent Process to Incentivize Innovation in Global Economy*, SYRACUSE SCI. & TECH. L. REP. 27 (2006) (citing Brenda Sandburg, *Inventor's Lawyer Makes a Pile of Patents*, RECORDER (2001), available at <http://www.phonetel.com/pdfs/LWTrolls.pdf> ("A patent troll is somebody who tries to make a lot of money off a patent that they are not practicing and have no intention of practicing and in most cases never practiced.")).

4. Edward Wyatt, *F.T.C. Votes for Inquiry into Patent Businesses*, N.Y. TIMES, Sept. 28, 2013, at B1.

5. Electronic Frontier Foundation, *FAQs for Lodsys Targets*, ELEC. FRONTIER FOUND., <https://www.eff.org/issues/faqs-lodsys-targets> (explaining that a "patent troll often tries to extract a settlement (or a license) that costs less than what litigating would, leaving many potential defendants to simply settle the matter.").

6. Lee, *supra* note 1.

7. White, *supra* note 3.

8. AM. INTELLECTUAL PROP. LAW ASS'N, 2011 REPORT OF THE ECONOMIC SURVEY 35 (2012).

spurned the offer and welcomed the litigation head-on.<sup>9</sup>

But what happens when a company like Lodsys sends a similar letter to an individual less valiant (and less wealthy) than Martha Stewart? According to one study, fifty-five percent of businesses defending a suit brought by a PAE make less than \$10 million per year and, thus, cannot afford Stewart's luxury of rejecting a settlement demand.<sup>10</sup> The bluff is simply too expensive to call.<sup>11</sup> PAEs<sup>12</sup> present a growing cause for concern.<sup>13</sup> One of the most concerning issues is that PAEs bring patent infringement suits against companies and individuals even though the underlying patents are of broad scope and in many cases teeter on the verge of invalidity.<sup>14</sup> There is considerable disagreement, however, about what to do about the abuse of invalid patents.<sup>15</sup>

One way of preventing entities from using invalid patents to extract settlements is to make it easier for others to challenge the validity of those patents. Although there are many ways to facilitate such challenges, this Note focuses on licensing agreements. In particular, this Note advocates for reducing the ability of patent holders to rely on pre-litigation no-challenge clauses (NCCs) to contractually estop their licensees<sup>16</sup> from bringing invalidity actions. An NCC is simply a clause in a licensing agreement stating that the licensee promises not to challenge the validity of the licensor's patent.<sup>17</sup>

The stakes of NCC enforceability are incredibly high. If NCCs are held

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9. Lee, *supra* note 1.

10. Robin Feldman et al., *The AIA 500 Expanded: The Effects of Patent Monetization Entities* 19 (UC Hastings College of the Law, 2013).

11. *See id.*

12. The term "patent assertion entity" has gained a bit of notoriety for its ability to elude a precise definition. For the purposes of this Note, I will adopt the definition used by Colleen Chien: PAEs are "entities . . . focused on the enforcement, rather than the active development or commercialization of their patents." Colleen Chien, *From Arms Race to Marketplace: The Complex Patent Ecosystem and its Implications for the Patent System*, 62 HASTINGS L.J. 297, 328 (2010).

13. *See* John R. Allison et al., *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 GEO. L.J. 677, 694 (2011).

14. *See id.*

15. Sannu K. Shrestha, *Trolls or Market-Makers? An Empirical Analysis of Nonpracticing Entities*, 110 COLUM. L. REV. 114, 119 (2010); *see* James F. McDonough, III, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*, 56 EMORY L.J. 189 (2006); Michael Risch, *Patent Troll Myths*, 42 SETON HALL L. REV. 457 (2012).

16. A brief note of licensing agreement terminology is warranted. In general terms, a licensor is "[o]ne who grants a license to another." BLACK'S LAW DICTIONARY (9th ed. 2009). Likewise, a licensee is "[o]ne to whom a license is granted." *Id.* In the context of patent licensing agreements, a patent holder becomes a licensor by licensing his patent rights to a licensee. The next section will describe the basic patent rights that a patent holder might choose to license.

17. Christian Chadd Taylor, Note, *No-Challenge Termination Clauses: Incorporating Innovation Policy and Risk Allocation into Patent Licensing Law*, 69 IND. L.J. 215, 236 n.137 (1993).

enforceable, then licensees are not only precluded from challenging patent validity by *bringing* lawsuits against their licensors, but they are also precluded from challenging validity while *defending* infringement lawsuits brought by their licensors.<sup>18</sup> In other words, if NCCs are held enforceable, then licensees cannot challenge patent validity in litigation, regardless of whether the licensee is the plaintiff or defendant.<sup>19</sup>

Since the U.S. Supreme Court handed down a seminal decision in 1969 in *Lear, Inc. v. Adkins*,<sup>20</sup> courts have evaluated the enforceability of NCCs using a balancing test, with hefty values occupying both sides of the scale.<sup>21</sup> Two arguments weigh in favor of the enforceability of NCCs. First, contract law generally prohibits a party from reneging on a contract merely because the deal does not turn out as well as that party initially thought.<sup>22</sup> A rule permitting loose adherence to contracts could lead to unfairness, as such a rule would demean agreements that parties presumably worked to negotiate.<sup>23</sup> Second, from a law and economics standpoint, efficient settlement of litigation is desirable as it reduces transaction costs.<sup>24</sup> Patent law is not an exception to the general rule in favor of settlement of litigation.<sup>25</sup> Weighing in favor of the non-enforceability of no-challenge clauses is one main argument. No one should have to pay a would-be monopolist a licensing fee for the right to use an invalid patent.<sup>26</sup> That invention is already part of the public domain.<sup>27</sup> By the same token, consumers should not have to pay the higher prices that such licensing fee arrangements cause.

The real problem is that attempts to accommodate these competing interests and to create a harmonious body of precedent have failed.<sup>28</sup> Patent jurisprudence needs—and American inventors deserve—a straightforward framework for reconciling these two interests, especially during a period in which entities are

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18. *Id.* at 215-18.

19. *Id.*

20. *Lear, Inc. v. Adkins*, 395 U.S. 653, 665 (1969).

21. See Andrew D. Kasenevich & Debohdonyaa Sengupta, *Licensee Estoppel: The Lear Doctrine, Rates v. Speakeasy, and Other Applications*, AIPLA.ORG, [http://www.aipla.org/committees/committee\\_pages/Licensing-and-Management-of-IP-Assets/Committee%20Documents/Licensee%20Estoppel\\_%20The%20Lear%20Doctrine%20Rates%20v%20%20Speakeasy%20and%20Other%20Applications.pdf](http://www.aipla.org/committees/committee_pages/Licensing-and-Management-of-IP-Assets/Committee%20Documents/Licensee%20Estoppel_%20The%20Lear%20Doctrine%20Rates%20v%20%20Speakeasy%20and%20Other%20Applications.pdf).

22. See *Lear*, 395 U.S. at 668.

23. See *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1370 (Fed. Cir. 2001).

24. *Asahi Glass Co. v. Penetech Pharms., Inc.*, 289 F. Supp. 2d 986, 991 (N.D. Ill. 2003) (Posner, J., sitting by designation).

25. *Id.*

26. See *Lear*, 395 U.S. at 670.

27. *Id.*

28. See *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 173-74 (2d Cir. 2012) (noting a circuit split regarding the enforceability of pre-litigation NCCs in which the U.S. Courts of Appeals for both the Second and Ninth Circuits disfavored enforceability and the Court of Appeals for the Federal Circuit (“Federal Circuit”) favored enforceability), *cert. denied*, 133 S. Ct. 932 (2013).

increasingly baiting operating companies into signing licensing agreements.

The purpose of this Note is to advocate that courts hold pre-litigation NCCs unenforceable to prevent patent holders, including PAEs, from using invalid patents to sue others. This Note proposes allowing a patent licensee to challenge the validity of the licensor's patent as long as the licensor and licensee have not yet engaged in litigation regarding the patent's validity. This rule will optimally balance the countervailing interests in protecting the public domain and respecting the doctrines of res judicata and contractual estoppel.

Part I of this Note provides background on patent law, explains why PAEs are a problem, and provides evidence that various entities, including PAEs, often initiate patent infringement suits based on invalid patents. Part II describes the origin and the evolution of the case law regarding the doctrine of licensee estoppel, which is the legal principle that has kept patent licensees from attacking the validity of patents. Part III lays out the four principal ways of resolving a patent dispute, and it indicates a circuit split regarding the enforceability of pre-litigation NCCs. Part IV addresses this circuit split by arguing that patent licensees should only be prohibited from challenging patent validity when such validity has already been established by a consent decree or final court order or when an NCC has been entered into mid-litigation, after the parties have had an opportunity to conduct discovery.

## I. THE WORLD OF PATENT LAW AND THE TROLLS THAT PATROL IT

### A. *Patent Law in a Nutshell*

Patent law incentivizes innovation by granting inventors temporary monopolies.<sup>29</sup> Upon being granted a patent, the owner of a patent (also known as a "patent holder" or "patentee") gains exclusive rights to an invention for twenty years<sup>30</sup> from the date the patent application was originally filed.<sup>31</sup> Taking advantage of these rights, patent owners can recoup the money that they invest in research and development.<sup>32</sup>

The constitutional basis for patent law resides in Article I, Section 8, Clause 8, of the U.S. Constitution.<sup>33</sup> According to that provision, Congress has the power "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their Writings and

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29. 35 U.S.C. § 154 (2012); Rochelle Cooper Dreyfus, *Dethroning Lear: Licensee Estoppel and the Incentive to Innovate*, 72 VA. L. REV. 677, 679 (1989).

30. 35 U.S.C. § 154.

31. U.S. patent law is statutorily enshrined in Title 35 of the United States Code. Although patents were formerly granted on a first-to-invent basis, the Act was simplified in 2011 to provide for a first-to-file system. See Leahy-Smith America Invents Act, Pub. L. No. 112-29, §125 Stat. 284 (2011).

32. See U.S. GOV'T ACCOUNTABILITY OFFICE, ASSESSING FACTORS THAT AFFECT PATENT INFRINGEMENT LITIGATION COULD HELP IMPROVE PATENT QUALITY 2 (2013).

33. See U.S. CONST. art. I, § 8, cl. 8.

Discoveries.<sup>34</sup>

To obtain a patent, an applicant must file an application, and certain requirements must be satisfied. The invention, for starters, must comprise patentable subject matter.<sup>35</sup> By statute, the realm of patentable material is limited to “any new and useful process, machine, manufacture, or any composition of matter, or any new and useful improvement thereof.”<sup>36</sup> Abstract ideas, physical phenomena, and laws of nature fall outside the scope of patentable subject matter.<sup>37</sup> In addition, patents must satisfy the statutory requirements of novelty, nonobviousness, and utility.<sup>38</sup> If an applicant for a patent fulfills these requirements and is granted a patent, then the applicant gains access to a number of important rights that can be vindicated through litigation.<sup>39</sup> For example, a person infringes a patent if that person “makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent.”<sup>40</sup> Specifically, patent holders may initiate actions for literal infringement,<sup>41</sup> contributory infringement,<sup>42</sup> and induced infringement.<sup>43</sup> In addition, and perhaps more importantly for the purposes of this Note, a patent holder wields the right to grant licenses to others to take advantage of any of the rights to a patent.<sup>44</sup>

#### *B. What Is a Patent Assertion Entity?*

Many types of entities license patents that turn out to be invalid.<sup>45</sup> This Note, however, primarily addresses one such type of patent holder known as a “patent assertion entity.” PAEs are known by several names including “non-practicing entities,” “patent monetization entities,” and more commonly and pejoratively, “patent trolls.”<sup>46</sup> For the purposes of this Note, these creatures will be referred to as patent assertion entities (PAEs). Also, this Note will refer to companies that actually sell goods or services other than patent monetization as “operating companies.”<sup>47</sup>

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34. *Id.*

35. *See* 35 U.S.C. § 101 (2012).

36. *Id.*

37. *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980).

38. 35 U.S.C. §§ 101-03 (2014).

39. *See* 35 U.S.C. § 281 (2012). Appellate patent litigation is entrusted exclusively to the Federal Circuit. 28 U.S.C. § 1295(a) (2012).

40. 35 U.S.C. § 271(a) (2012).

41. *See id.*

42. *Id.* § 271(c).

43. *Id.* § 271(b).

44. 35 U.S.C. § 261 (2013).

45. *See* Risch, *supra* note 15, at 481.

46. Sara Jeruss et al., *The America Invents Act 500: Effects of Patent Monetization Entities on US Litigation*, 11 DUKE L. & TECH. REV. 357, 359-60 (2012).

47. *See* Feldman et al., *supra* note 10.

To be sure, PAE is a loaded term, entailing a variety of possible definitions and connotations. Peter Detkin, former assistant general counsel for Intel, coined the term “patent troll” in 2001.<sup>48</sup> In Detkin’s view, a patent troll is a person who tries to make a lot of money off a patent that he is not currently practicing and has no intention of practicing in the future.<sup>49</sup> This version of the concept, although widely shared, bears a clearly negative connotation. Just as the folkloric creatures charge travelers to cross bridges that the creatures may or may not have built, patent trolls charge operating companies to use the inventions that the patent trolls may or may not have validly patented.<sup>50</sup> This negative connotation, however, is unfortunate because Detkin’s definition sweeps up many entities that do contribute to society. For example, individual inventors, universities, and product manufacturing companies technically “[do not] produce a product or service, but instead make[ ] money from licensing and patent assertion primarily.”<sup>51</sup> Universities, in particular, do not fit the mold of a typical PAE for at least two reasons. First, they do not acquire patents simply to assert them in litigation.<sup>52</sup> Instead, universities develop patents through the research of professors and students.<sup>53</sup> Second, patent-holding universities initiate patent infringement lawsuits relatively rarely, thus reinforcing the notion that such litigation is not their goal.<sup>54</sup> For the purposes of this Note, universities are not considered PAEs.<sup>55</sup>

It is perhaps more fruitful to describe PAEs’ routines. As Martha Stewart knows all too well, PAEs often send “demand letters.”<sup>56</sup> In general, the letters have at least three core elements: (1) they inform the alleged patent infringer of his or her probable infringement of the letter-sender’s patent, (2) they threaten to file a lawsuit alleging infringement and, most importantly, (3) they propose avoiding litigation by entering into a licensing or settlement agreement.<sup>57</sup>

PAEs offer to settle for amounts they deliberately set below the cost the patentee would likely incur litigating the dispute.<sup>58</sup> Therefore, confronted with

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48. Edward Wyatt, *Inventive, at Least in Court*, N.Y. TIMES, July 13, 2013, at B1.

49. Brenda Sandburg, *You May Not Have a Choice. Trolling for Dollars*, RECORDER (July 30, 2001), <http://www.phonetel.com/pdfs/LWTrolls.pdf>.

50. BRIAN T. YEH, CONG. RESEARCH SERV., AN OVERVIEW OF THE “PATENT TROLLS” DEBATE 4 (2013).

51. Jaconda Wagner, *Patent Trolls and the High Cost of Litigation to Business and Start-Ups - A Myth?*, 45-OCT MD. B. J. 12 (2012).

52. Risch, *supra* note 15, at 468.

53. *Id.*

54. Feldman et al., *supra* note 10, at 59.

55. For a more detailed discussion of the benefits of PAEs, see McDonough, *supra* note 15, at 199.

56. James R. Farrand, *Territoriality and Incentives Under the Patent Laws: Overreaching Harms U.S. Economic and Technological Interests*, 21 BERKELEY TECH. L.J. 1215, 1286 (2006).

57. The United States Patent and Trademark Office, *I Got a Letter . . .*, USPTO.GOV, [http://www.uspto.gov/patents/litigation/I\\_got\\_a\\_letter.jsp](http://www.uspto.gov/patents/litigation/I_got_a_letter.jsp) (last modified Feb. 20, 2014 8:30 AM).

58. *Id.* at 1; David L. Schwartz, *The Rise of Contingent Fee Representation in Patent*

a threatening letter and an offer from a PAE, an operating company has two potentially expensive options: (1) engage in a licensing or settlement agreement, or (2) engage in costly, and often unpredictable, litigation asserting non-infringement and/or challenging the validity of the underlying patent.<sup>59</sup> The specter of having to pay for those options causes operating companies to devote more resources to doomsday preparations and fewer resources to researching and developing their products.<sup>60</sup> In addition, the specter of patent trolling dissuades venture capitalists from investing in businesses that may be subject to PAE demands in the future.<sup>61</sup> As a result, the *in terrorem* effect of PAEs essentially “taxes” operating companies.<sup>62</sup> Ultimately, consumers pay for these licensing agreements and litigation because they face higher prices.<sup>63</sup>

Practically, it is difficult to know exactly how often PAEs successfully exact licensing fees from the recipients of their demand letters because such arrangements are often confidential components of licensing agreements.<sup>64</sup> The same mystery enshrouds the amounts charged for these licenses pursuant to licensing agreements.<sup>65</sup> Nevertheless, Robin Feldman, a prominent patent law scholar, has collected some data regarding licensing agreements.<sup>66</sup> In one study, forty-six operating companies provided data on the costs of settling patent infringement lawsuits brought by PAEs; on average those companies spent approximately \$30 million per settlement, including both legal fees and licensing agreements.<sup>67</sup>

PAEs do not just bait operating companies into costly settlements; they provoke costly litigation as well. Startlingly, Feldman’s research revealed that as of 2012, PAEs initiated the majority of the patent litigation in the United States.<sup>68</sup> The problem of patent trolling is more severe today compared to 2007 and, indeed, even compared to 2010.<sup>69</sup> The numbers speak for themselves: PAEs initiated 29% of patent litigation in 2010, 45% in 2011, and 61% in 2012.<sup>70</sup> From

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*Litigation*, 64 ALA. L. REV. 335, 370 (2012).

59. Jeremiah Chan & Matthew Fawcett, *Footsteps of the Patent Troll*, 10 INTELL. PROP. L. BULL. 1, 4 (2005).

60. YEH, *supra* note 50, at 7; Chan & Fawcett, *supra* note 59, at 4.

61. YEH, *supra* note 50, at 7.

62. Anna Mayergoyz, *Lessons from Europe on How to Tame U.S. Patent Trolls*, 42 CORNELL INT’L L.J. 241, 251 (2009).

63. *Id.*

64. Allison et al., *supra* note 13, at 705. Once litigation commences, however, nearly ninety percent of patent litigation involving PAEs results in settlement. Stjepko Tokic, *The Role of Consumers in Deterring Settlement Agreements Based on Invalid Patents: The Case of Non-Practicing Entities*, 2012 STAN. TECH. L. REV. 2, 1.

65. Allison et al., *supra* note 13, at 705.

66. See Feldman et al., *supra* note 10.

67. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 32, at 27.

68. Feldman, *supra* note 10, at 9.

69. See *id.*

70. *Id.* at 16.

2000 to 2010, the number of patent infringement lawsuits increased marginally.<sup>71</sup> But from 2010 to 2011, that number increased by one-third (31%).<sup>72</sup> From 2007 to 2011, the number of defendants in overall patent litigation increased by 129%.<sup>73</sup> The amount of money stashed behind these figures is staggering. One study revealed that PAE activity costs defendants and licensees \$29 billion in 2011 alone.<sup>74</sup>

### C. *The Problem of Patent Invalidity*

Unfortunately, invalid patents are not uncommon.<sup>75</sup> Patents are often granted to inventions that do not fulfill the statutory patent requirements.<sup>76</sup> As noted by the U.S. Supreme Court, the individuals who apply for—and eventually are granted—invalid patents sometimes intend to consciously defraud the United States Patent and Trademark Office (USPTO).<sup>77</sup> In other instances, the individuals are unaware that their requested patents are invalid.<sup>78</sup>

When it comes to winning patent litigation on the merits, PAEs have a terrible batting average.<sup>79</sup> In fact, according to one study, PAEs win only eight percent of the merits judgments to which they are parties.<sup>80</sup> Other entities win forty percent of such cases.<sup>81</sup> The reason for this is simple. Although PAEs accumulate patent portfolios of varying sizes, their patents are often overly broad and invalid.<sup>82</sup> Although broad patents potentially occupy more intellectual territory, they also often tend to be invalid by reason of anticipation by prior art.<sup>83</sup> Some of the patents issued by the USPTO “range[ ] from the somewhat ridiculous to the truly absurd.”<sup>84</sup> Some patents “do not provide notice about their

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71. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 32, at 14.

72. *Id.*

73. *Id.* at 15.

74. James Bessen & Michael J. Meurer, *The Direct Costs from NPE Disputes*, 99 CORNELL L. REV. 387, 389 (2014).

75. Allison et al., *supra* note 13, at 678.

76. *See id.*

77. *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).

78. *Id.* at 671.

79. Allison et al., *supra* note 13, at 694.

80. *Id.*

81. *Id.*

82. David L. Schwartz & Jay P. Kesan, *Analyzing the Role of Non-Practicing Entities in the Patent System* 123 (Chicago-Kent Coll. Of Law Legal Studies, Paper No. 2012-13, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2117421](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2117421); Chan & Fawcett, *supra* note 59, at 4.

83. Giles S. Rich, *The Proposed Patent Legislation: Some Comments*, 35 GEO. WASH. L. REV. 641, 644 (1967). To put it briefly, “prior art . . . is knowledge that is available, including what would be obvious from it, at a given time, to a person of ordinary skill in an art.” *Kimberly-Clark Corp. v. Johnson & Johnson*, 745 F.2d 1437, 1453 (Fed. Cir. 1984) (internal citations omitted).

84. *Bilski v. Kappos*, 130 S. Ct. 3218, 3259 (2010) (Breyer, J., concurring) (quoting In re

boundaries.”<sup>85</sup> In a sense, bad patents are unavoidable. As one court put it, “the grant of a patent simply represents a legal conclusion reached by the Patent Office—a conclusion reached in an *ex parte* proceeding and based upon factors as to which reasonable men can differ widely.”<sup>86</sup>

Moreover, the existence of invalid patents harms the public. The U.S. Supreme Court put it aptly:

A patent by its very nature is affected with a public interest . . . [It] is an exception to the general rule against monopolies and to the right to access to a free and open market. The far-reaching social and economic consequences of a patent, therefore, give the public a paramount interest in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.<sup>87</sup>

The damage wrought by invalid patents can be understood in light of the constitutional justification for patent law. As the U.S. Supreme Court emphasized in *Graham v. John Deere Co.* (1966), the constitutional authorization for Congress “To promote the Progress of . . . useful Arts” by providing for the issuance of patents is both a power *and a limitation*.<sup>88</sup> The clause constitutes a limitation because, for example, when the USPTO issues an invalid patent to a PAE, the USPTO has then transgressed its constitutional mandate.<sup>89</sup> Practically speaking, the PAE’s invalid patent does not compensate society for the exclusive monopolistic rights that it affords its owner.<sup>90</sup> Only inventions that add to the sum of human knowledge “justif[y] the special inducement of a limited private monopoly.”<sup>91</sup>

It is important, nevertheless, to refrain from overstating the harm posed by invalid patents, and the extent to which PAEs perpetuate invalid patents. As to the first point, it must be remembered that patent validity is an extremely slippery concept.<sup>92</sup> Because the criteria regarding patent validity are so subjective, it is

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Bilski, 545 F.3d 943, 1004 (Fed. Cir. 2008) (Mayer, J., dissenting)).

85. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 32, at 28.

86. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 168 (2d Cir. 2012) (citing *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969)) (internal citations omitted), *cert. denied*, 133 S. Ct. 932 (2013).

87. *Blonder-Tongue Lab., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 343 (1971) (quoting *Precision Instrument Mfg. Co. v. Auto. Maint. Mach. Co.*, 324 U.S. 806, 816 (1945)).

88. *Graham v. John Deere Co. of Kan. City*, 383 U.S. 1, 5 (1966).

89. *Id.*

90. *See id.* at 9.

91. *Id.*

92. *See Stevenson v. Sears, Roebuck & Co.*, 713 F.2d 705, 711 (Fed. Cir. 1983) (citing *Harries v. Air King Prod. Co.*, 183 F.2d 158, 162 (2d Cir. 1950) (L. Hand, C.J.)). The issue of patent validity is often “as fugitive, impalpable, wayward, and vague a phantom as exists in the whole paraphernalia of legal concepts . . . . If there be an issue more troublesome, or more apt for litigation than this, we are not aware of it.” *Harries*, 183 F.2d at 162.

often unclear whether a patent is invalid.<sup>93</sup> Therefore, given the uncertainty regarding invalidity, it is often unclear whether rendering a given NCC unenforceable would facilitate the elimination of an allegedly invalid patent. Furthermore, as to the second point, PAEs are not the only type of entity that holds invalid patents.<sup>94</sup> There has been relatively little research conducted regarding PAEs and the patents that they wield in litigation.<sup>95</sup> As law professor Gerard Magliocca put it, “Like most fresh legal questions, the debate on patent trolls is long on passion and short on proof.”<sup>96</sup> At any rate, although the criteria by which invalidity is judged entail some subjectivity, invalid patents do exist, and they are sometimes licensed to licensees. Thus, a question is raised: May licensees successfully challenge the validity of the licensor’s patent?

## II. BRIEF HISTORY OF THE DOCTRINE OF LICENSEE ESTOPPEL

The ability of patent licensees to challenge the validity of the licensed patent is extremely important, especially in light of the expense of patent litigation and licensing agreements.<sup>97</sup> From the licensor’s perspective, the stakes of fending off a licensee’s validity suit are extremely high.<sup>98</sup> If a patent is adjudged invalid just once, then, thanks to the doctrine of non-mutual defensive collateral estoppel, the patent holder may be estopped from bringing successful infringement suits against *any* alleged infringer in the future.<sup>99</sup>

### A. Overview of Licensee Estoppel and its History in Pre-Lear Cases

Again, it is already known how Martha Stewart deals with offers to enter into licensing agreements.<sup>100</sup> Stewart unsheathes the sword of litigation.<sup>101</sup> But, when a party actually decides to enter into the licensing agreement with a PAE—or any entity, for that matter—and that licensing agreement includes an NCC, has the licensee no hope of ever challenging the validity of the entity’s patent in the future?

Prior to 1969, such a challenge would have been completely out of the

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93. The United States Patent and Trademark Office, *About Patents*, USTPO.GOV, [http://www.uspto.gov/patents/litigation/What\\_is\\_a\\_patent.jsp](http://www.uspto.gov/patents/litigation/What_is_a_patent.jsp) (last modified Feb. 20, 2014, 8:36 AM).

94. Risch, *supra* note 15, at 481.

95. *Id.* at 459.

96. Gerard Magliocca, *Blackberries and Barnyards: Patent Trolls and the Perils of Innovation*, 82 NOTRE DAME L. REV. 1809, 1810 (2007).

97. Joseph Farrell & Robert P. Merges, *Incentives to Challenge and Defend Patents: Why Litigation Won’t Reliably Fix Patent Office Errors and Why Administrative Patent Review Might Help*, 19 BERKLEY TECH. L.J. 943, 964 (2004).

98. *Id.*

99. *Blonder-Tongue Lab., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 325 (1971).

100. *See* Lee, *supra* note 1.

101. *See id.*

question.<sup>102</sup> The prevailing body of case law militated against the right of licensees to challenge the validity of the patentee's patent after entering into a license agreement.<sup>103</sup> In 1950, the U.S. Supreme Court handed down its decision in *Automatic Radio Manufacturing Co. v. Hazeltine Research*, arguably the best-known case regarding licensee estoppel.<sup>104</sup> According to *Hazeltine*, "[t]he general rule [of licensee estoppel] is that the licensee under a patent license agreement may not challenge the validity of the licensed patent."<sup>105</sup> This rule has harsh consequences for licensees trying to get out from under a licensing agreement. Under *Hazeltine*'s rule, the inclusion of an NCC in the licensing agreement is irrelevant to the agreement's preclusiveness of subsequent validity challenges.<sup>106</sup> Just by virtue of receiving the benefits of the licensing agreement, the licensee loses all hope of challenging the validity of the underlying patent.<sup>107</sup> Of course, patent holders, including PAEs, stand to benefit from *Hazeltine*'s holding because it increases the enforceability of the licensing arrangements to which alleged infringers often agree.<sup>108</sup>

Under the doctrine of licensee estoppel, "a licensee of intellectual property 'effectively recognizes the validity of that property and is estopped from contesting its validity in future disputes.'"<sup>109</sup> In essence, licensee estoppel prohibits a party to a patent licensing agreement from simultaneously benefiting from and challenging the agreement.<sup>110</sup>

The licensee's inability to challenge seems counterintuitive at least in part

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102. See *Bowers Mfg. Co. v. All-Steel Equip., Inc.*, 275 F.2d 809, 812 (9th Cir. 1960) (reasoning that "[t]he licensee has bought temporary peace by agreeing to the license, and should be required to abide by his bargain"); *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 836 (1950) (holding that "the general rule is that the licensee under a patent license agreement may not challenge the validity of the licensed patent in a suit for royalties due under the contract"); *United States v. Harvey Steel Co.*, 196 U.S. 310, 317 (1905); *Kinsman v. Parkhurst*, 59 U.S. 289, 292-93 (1855); see also Lorelei Ritchie, *Reconciling Contract Doctrine with Intellectual Property Law: An Interdisciplinary Solution*, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 105, 122-23 (2008).

103. See *Bowers Mfg. Co.*, 275 F.2d at 812; *Hazeltine*, 339 U.S. at 836; *Harvey Steel Co.*, 196 U.S. at 317; *Kinsman*, 59 U.S. at 292-93; see also Ritchie, *supra* note 102, at 122-23.

104. See *Hazeltine*, 339 U.S. at 827.

105. *Id.* at 836. The doctrine of patent licensing estoppel showcased in *Hazeltine* is a species of estoppel by contract. According to *Black's Law Dictionary*, estoppel by contract is "[a] bar that prevents a person from denying a term, fact, or performance arising from a contract that the person has entered into." BLACK'S LAW DICTIONARY, *supra* note 16, at 630.

106. *Hazeltine*, 339 U.S. at 836.

107. *Id.*

108. *Id.*

109. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 167 (2d Cir. 2012) (quoting *Idaho Potato Comm'n v. M&M Produce Farm & Sales*, 335 F.3d 130, 135 (2d Cir. 2003)), *cert. denied*, 133 S. Ct. 932 (2013).

110. See *id.*

because patents are never definitively valid.<sup>111</sup> True, the issuance of a patent by the USPTO creates a presumption of validity,<sup>112</sup> but the patent's validity can still be challenged.<sup>113</sup> In general, a party accused of patent infringement can fight back in two ways. First, if the alleged patent infringer is sued, then he can attack the patent's validity in court as an affirmative defense.<sup>114</sup> Second, the would-be patent infringer can go on the offensive and file a "declaratory judgment action" asking the court to declare the patent in question invalid.<sup>115</sup> Again, the doctrine of licensee estoppel, if it is still viable, forecloses both of these options.

Almost two decades after *Hazeltine* was decided, however, the U.S. Supreme Court expressly overruled *Hazeltine* in the seminal decision *Lear, Inc. v. Adkins*.<sup>116</sup> As result, the Court propelled patent licensing agreements into the modern era.<sup>117</sup>

### B. All Hail King Lear!

In 1969, the death knell sounded for the doctrine of licensee estoppel. The U.S. Supreme Court handed down its decision in *Lear*, rejecting the doctrine of licensee estoppel and upholding the right of licensees to challenge the validity of patents.<sup>118</sup> At its core, *Lear* stands for a bedrock principle of patent law: "that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent."<sup>119</sup> This decision warrants a relatively in-depth exegesis because its central doctrine—the so-called "*Lear* doctrine"—is often referenced in modern case law regarding patent licensee estoppel.<sup>120</sup>

The stage of *Lear* is set in the aviation industry during the mid-20th century.<sup>121</sup> As planes became faster in the 1950s, a demand emerged for more accurate gyroscopes—devices used by pilots to monitor the direction and altitude of the plane.<sup>122</sup> An inventor named John Adkins developed an improved version of the gyroscope. In an effort to capitalize on his discovery, Adkins licensed the

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111. *Blonder-Tongue Lab., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 338 (1971).

112. 35 U.S.C. § 282 (2012).

113. See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 32, at 8.

114. *Id.* at 9 n.21.

115. *Id.*

116. *Lear, Inc. v. Adkins*, 395 U.S. 653, 671 (1969) (declaring that *Hazeltine* was "itself the product of a clouded history, should no longer be regarded as sound law with respect to its 'estoppel' holding, and that holding is now overruled").

117. *Id.*

118. *Id.*

119. *Id.* at 668.

120. See *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 167 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013); *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1361 (Fed. Cir. 2010); *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1368 (Fed. Cir. 2001); *Foster v. Hallco Mfg. Co., Inc.*, 947 F.2d 469, 474 (Fed. Cir. 1991).

121. *Lear*, 395 U.S. at 655.

122. *Id.*

invention to an aviation company called Lear, Inc. (“Lear”) by way of a written agreement.<sup>123</sup> Per that agreement, Lear (the licensee) agreed to make royalty payments to Adkins (the licensor) at defined intervals.<sup>124</sup> At the time, Adkins had applied for, but had not yet been granted, a patent on the gyroscope.<sup>125</sup>

The agreement did not contain a typical NCC because none of its provisions expressly precluded Lear from challenging the validity of the gyroscope patent.<sup>126</sup> The agreement did, however, state that Lear reserved the right to terminate the agreement if the USPTO rejected the application or if the patent was ever declared invalid.<sup>127</sup> In a sense, this term is similar to an NCC because it precludes the licensee from terminating the agreement *for any reason*.<sup>128</sup> In other words, by the letter of the agreement, not only is the licensee prohibited from terminating the agreement based on a validity challenge, but also from terminating the agreement based on any type of challenge whatsoever.<sup>129</sup> Therefore, this contract term is analogous to the type of NCC that PAEs and other patent holders insert into their licensing agreements. As a result, in *Lear*, Adkins plays the role of a PAE in the sense that he owns an invention and attempts to contractually bind Lear, an entity seeking to practice the invention.<sup>130</sup>

Several years after signing the agreement, Lear became convinced that the invention failed the statutory requirement of novelty because it added nothing to the existing knowledge of gyroscopes.<sup>131</sup> As a result, Lear stopped paying royalties, alleging that Adkins’ pending patent application would never be granted because his would-be patent was invalid.<sup>132</sup> Much to Lear’s chagrin, however, Adkins eventually obtained a patent for his invention.<sup>133</sup> And sure enough, an all-out battle ensued, ultimately reaching the steps of the U.S. Supreme Court.<sup>134</sup> Adkins, patent in hand, promptly brought suit against Lear for infringement.<sup>135</sup> During the course of the litigation, Lear challenged the validity

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123. *Id.*

124. *Id.*

125. *Id.* at 658.

126. *Id.* at 657-58.

127. *Id.* at 657.

128. Nicholas Roper, *Limiting Unfettered Challenges to Patent Validity: Upholding No-Challenge Clauses in Pre-Litigation Patent Settlements Between Preexisting Parties to a License*, 35 CARDOZO L. REV. 1649, 1651 n.8 (2014).

129. *Id.*

130. *Lear*, 395 U.S. at 655.

131. *See id.* at 659. Using patent law shoptalk, Lear would argue that Adkins’ inventive concept was “anticipated” (i.e., preempted) by the “prior art” (i.e., the existing knowledge in the field). ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 226 (2007).

132. *Lear*, 395 U.S. at 659.

133. *Id.* at 660.

134. *Id.* at 655.

135. *Id.*

of the patent.<sup>136</sup>

In its holding, the Court not only allowed *Lear* the opportunity to challenge the validity of the gyroscope's patent, but also allowed *Lear* to avoid payment of all royalties accruing after the PTO granted Adkins' patent.<sup>137</sup> The beauty of the opinion, however, lies in the logic that the Court invoked on the way to this holding. In *Lear*, as other circuit courts have done in modern cases addressing the validity of a no-challenge clause, the Court engaged in a balancing act.<sup>138</sup> The Court balanced the interest in encouraging competition and the free exchange of ideas against the goals of contract law and the interest in settling to avoid the high costs of litigation.<sup>139</sup> The Court decided that the former interest was weightier because it better furthered the central objective of patent law enshrined in the U.S. Constitution—"to promote the Progress of Science and useful Arts."<sup>140</sup> In other words, an invalid patent is not entitled to any protection whatsoever because its invalid claims belong to the public domain and may be dedicated to the common good.<sup>141</sup> *Lear* gave at least four reasons for allowing licensees to challenge validity, and all four are still relevant today, especially in light of the increasing prevalence of the invalid patent problem.<sup>142</sup> First, the ability to challenge a patent's validity must be preserved because the USPTO is not infallible, and indeed, the Patent Office often makes its decisions in an *ex parte* proceeding, without the aid of opposing arguments.<sup>143</sup> Second, by statute, a patent's validity is never definitively established.<sup>144</sup> Third, the patent holder is already shielded by a presumption of validity.<sup>145</sup> Fourth, licensees are often uniquely situated as the only entities with enough financial stakes in the matter to challenge an invalid patent, so they are the only capable champions of the public interest.<sup>146</sup> The Court reasoned that if licensees are restrained from challenging validity, then the licensors of invalid patents may continue to exact tribute from the public without resistance.<sup>147</sup>

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136. *Id.* at 657-60.

137. *Id.* at 674.

138. *Id.* at 669-70; *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 171 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013); *see* *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1361 (Fed. Cir. 2010); *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1368 (Fed. Cir. 2001).

139. *Lear*, 395 U.S. at 670-71 ("Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain . . . . We think it plain 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.").

140. U.S. CONST. art. I, § 8, cl. 2; *Lear*, 395 U.S. at 670.

141. *Lear*, 395 U.S. at 670.

142. *See id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. *See id.*

To be clear, the inventor, Adkins, was not a PAE because he actually conceived of his gyroscope and endeavored to use it.<sup>148</sup> However, if a practicing inventor's patent was vulnerable to a validity challenge, a PAE's patent is even more vulnerable. The *Lear* Court valued the quid pro quo justification for extending patent protection, and thus, it arguably would not sympathize with a PAE that fails to compensate society for giving it a monopoly.<sup>149</sup>

As discussed below, *Lear* has received mixed treatment from several courts. Many courts have adopted the *Lear* balancing test.<sup>150</sup> Some courts disagree about the relative weights that should be attached to the competing interests.<sup>151</sup> Other courts attempt to distinguish *Lear* on the facts, contending that no-challenge clauses are inviolable when their underlying settlement agreements were entered into *after* the litigation begins.<sup>152</sup> Admittedly, it is true that the licensing agreement in *Lear* did not contain an NCC.<sup>153</sup> This Note argues, however, that the main arguments of *Lear* also justify a licensee's breaching of an NCC before litigation begins, even where that NCC is "clear and unambiguous."<sup>154</sup> To understand why, it is necessary to examine the four possible outcomes in a patent dispute, as referenced in the Second Circuit Court of Appeals' majority opinion in *Rates Tech., Inc. v. Speakeasy, Inc.*<sup>155</sup>

### III. FOUR ENDGAMES OF A PATENT INFRINGEMENT DISPUTE

In 2012, the Second Circuit had before it a case that demanded clarification regarding the preclusiveness of an NCC that was entered into before the commencement of any patent litigation between the parties.<sup>156</sup> But rather than analyzing the preclusiveness of NCCs in the abstract, the Second Circuit analyzed the preclusiveness of NCCs as they might appear in the four potential resolutions of patent disputes.<sup>157</sup>

#### *A. Court Entering Final Judgment After Full Litigation*

In this first scenario, a court enters a final judgment on the merits against a

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148. *Id.* at 655.

149. *See id.* at 670.

150. *See Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 167 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013); *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1361-62 (Fed. Cir. 2010); *Idaho Potato Comm'n v. M&M Produce Farm & Sales*, 335 F.3d 130, 135 (2d Cir. 2003); *Foster v. Hallco Mfg. Co., Inc.*, 947 F.2d 469, 481 (Fed. Cir. 1991).

151. Alfred C. Server & Peter Singleton, *Licensee Patent Validity Challenges Following MedImmune: Implications for Patent Licensing*, 32 HASTINGS SCI. & TECH. L.J. 245, 438-39 (2010).

152. *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1370 (Fed. Cir. 2001).

153. *Id.* at 1368.

154. *See Lear*, 395 U.S. at 653.

155. *Rates Tech., Inc.*, 685 F.3d at 169-71.

156. *Id.* at 164.

157. *Id.* at 169-71.

patent infringer in a fully litigated lawsuit. It is well-settled that following such a judgment, the patent's validity is treated as *res judicata*, and the patent infringer is not permitted to further challenge the validity of the patent.<sup>158</sup> The doctrine of *res judicata* “embod[ies] the public policy of putting an end to litigation.”<sup>159</sup> At bottom, *res judicata* “holds that a final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action.”<sup>160</sup>

The *Lear* decision, strong as it was, does not allow a licensee to challenge patent validity after losing on the merits in a full-fledged patent infringement suit.<sup>161</sup> Although the *Lear* Court did not directly address this scenario, the principle of *res judicata*—the public policy of putting an end to litigation<sup>162</sup>—is paramount, arguably even in the field of patent law. Courts would be useless to society, and particularly to patent holders who properly seek to vindicate their rights, if “conclusiveness did not attend the[ir] judgments . . . in respect of all matters properly put in issue and actually determined by them.”<sup>163</sup> More to the point, if alleged patent infringers could call for a mulligan after losing a final judgment, then patent ownership would become truly unpredictable and patent holders would be unfairly subject to multiple trials. For these reasons, no court has entertained the possibility of stretching the *Lear* doctrine to suspend the principle of *res judicata* after a final judgment on the merits.<sup>164</sup>

#### *B. Court Issuing Consent Decree Containing an NCC After Some Litigation*

The second endgame occurs when there is no final judgment on the merits in a patent lawsuit, but opposing parties decide to settle the dispute by signing off on the judge's consent decree.<sup>165</sup> Like an entry of judgment after full litigation, it is well-settled that a consent decree operates as *res judicata*, and thus precludes a patent infringer from subsequently challenging the patent's validity.<sup>166</sup> Only infrequently have courts failed to uphold the preclusiveness of NCCs contained

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158. *See id.* at 169.

159. *Foster v. Hallco Mfg. Co., Inc.*, 947 F.2d 469, 475-76 (Fed. Cir. 1991).

160. *Monahan v. N.Y. City Dep't of Corr.*, 214 F.3d 275, 284 (2d Cir. 2000).

161. *See Foster*, 947 F.2d at 476.

162. *Id.* at 475-76.

163. *See id.* at 476 (quoting *Southern Pacific R.R. Co. v. United States*, 168 U.S. 1, 49 (1897)).

164. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 169 (2d Cir. 2012) (citing *Foster*, 947 F.2d at 476), *cert. denied*, 133 S. Ct. 932 (2013).

165. According to *Black's Law Dictionary*, a consent decree is a “court decree that all parties agree to.” BLACK'S LAW DICTIONARY, *supra* note 16.

166. *Siegel v. Nat'l Periodical Publ'ns Inc.*, 508 F.2d 909, 913 (2d Cir. 1974); *see United States v. S. Ute Tribe or Band of Indians*, 402 U.S. 159, 174 (1971); *United States v. Swift & Co.*, 286 U.S. 106, 115 (1932); *Interdynamics, Inc. v. Firma Wolf*, 653 F.2d 93, 97-98 (3d Cir. 1981); *Am. Equip. Corp. v. Wikomi Mfg. Co.*, 630 F.2d 544, 547-48 (7th Cir. 1980); *Kiwi Coders Corp. v. Acro Tool & Die Works*, 250 F.2d 562, 568 (7th Cir. 1957).

within patent consent decrees.<sup>167</sup> For the purposes of licensee estoppel, modern courts treat consent decrees and judgments similarly.<sup>168</sup> Consent decrees generally estop parties from attacking a patent's validity subject to one important nuance—that the decree includes stipulations to both validity *and* infringement.<sup>169</sup> The underlying rationale is that if the parties to the decree only agree that infringement did not occur, then the alleged infringer does not have strong incentives to contest the patent's validity, which is presumed anyway.<sup>170</sup> As one court put it, “judicial decrees disposing of issues in active litigation cannot be treated as idle ceremonies without denigrating the judicial process.”<sup>171</sup> At the same time, however, consent decrees should be narrowly construed in order to effectuate the ideals highlighted by *Lear*.<sup>172</sup>

*C. Parties Agree to an NCC as Part of a Settlement Agreement  
During Litigation*

Under the third endgame, the parties initiate litigation, and at some point, enter into a settlement agreement.<sup>173</sup> If the settlement agreement does not contain an NCC, then the licensee is most likely not estopped from subsequently challenging the underlying patent's validity.<sup>174</sup> The U.S. Supreme Court has never confirmed this, but the Second Circuit handed down an opinion holding as much in *Warner-Jenkinson Co. v. Allied Chemical Corp.*<sup>175</sup> If, on the other hand, that mid-litigation settlement agreement does contain an NCC, and there has been an opportunity to conduct discovery regarding patent validity, then patent validity may not be subsequently challenged by the patent holder's counterparty to the settlement agreement.<sup>176</sup> There is no controversy surrounding this situation.<sup>177</sup> Because settlement agreements accompanied by dismissals with prejudice are afforded the same preclusive effect as consent decrees, the equities weigh overwhelmingly in favor of estopping licensees from renegeing on their NCCs.<sup>178</sup>

One might well wonder why the powerful pro-licensee rationale of *Lear* is

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167. *Kraly v. Nat'l Distillers & Chem. Corp.*, 502 F.2d 1366, 1368 (7th Cir. 1974).

168. *Rates Tech., Inc.*, 685 F.3d at 169.

169. *Foster*, 947 F.2d at 483.

170. *See Wikomi*, 630 F.2d at 547.

171. *Wallace Clark & Co. v. Acheson Indus, Inc.*, 532 F.2d 846, 849 (2d Cir. 1976).

172. *See Foster*, 947 F.2d at 480.

173. *See Farrell & Merges, supra* note 97, at 955.

174. *Warner-Jenkinson Co. v. Allied Chem. Corp.*, 567 F.2d 184, 188 (2d Cir. 1977).

175. *Id.*

176. *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1370 (Fed. Cir. 2001). It bears mentioning that the enactment of mid-litigation settlement agreements only precludes the parties to the agreement from subsequently challenging patent validity. *See id.* It does not preclude third-parties who have nothing to do with the settlement agreement. *See id.*

177. *See Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 170 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013); *see Flex-Foot, Inc.*, 238 F.3d at 1370.

178. *Flex-Foot, Inc.*, 238 F.3d at 1367-68.

not strong enough to overcome the policy of res judicata and to allow licensees to challenge patent validity in spite of a settlement agreement containing an NCC. The *Lear* Court, however, simply did not consider the policy of res judicata.<sup>179</sup> The facts of *Lear* involved a pre-litigation licensing agreement—not a mid-litigation settlement or consent decree—and the Court nowhere intimates that its rationale can be extended to situations beyond pre-litigation licensing agreements.<sup>180</sup> More to the point, no court has ever ventured to hold that the *Lear* doctrine is strong enough to trump res judicata,<sup>181</sup> and this Note does not either.

In 2012, the United States Court of Appeals for the Federal Circuit handed down a case entitled *Flex-Foot, Inc. v. CRP, Inc.* in which the court stated the circumstances under which mid-litigation settlement agreements and consent decrees are preclusive and the rationale for that preclusiveness.<sup>182</sup> Basically, the court held that an NCC does not suddenly become preclusive just because the parties to a patent lawsuit write it into a settlement agreement at some point during the litigation.<sup>183</sup> Rather, to become preclusive as to further validity challenges, the NCC must be written into a settlement agreement that is reached *after the patent licensee has an opportunity to engage in discovery regarding the patent's validity*.<sup>184</sup> The Federal Circuit did not explicitly state the rationale underlying this rule.<sup>185</sup> Presumably, though, a licensee who agrees to an NCC after having an opportunity to conduct discovery regarding patent validity is making a relatively *informed* decision. Also, the Federal Circuit did not expressly elaborate on exactly how much discovery must be performed regarding a patent's validity.<sup>186</sup> The court did, however, approve of its previous decision in *Hemstreet v. Spiegel, Inc.*, in which it found an NCC to be preclusive even though the underlying settlement agreement was reached just *one week* into the litigation.<sup>187</sup>

The rationale for *Flex-Foot's* rule is that a party to patent litigation should only get one swing at the piñata.<sup>188</sup> The efficiency of patent litigation would suffer immensely if parties could freely challenge patent validity after making an informed decision to sign a document promising to do the opposite. In short, the

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179. See *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

180. See *id.*

181. *Foster v. Hallco Mfg. Co., Inc.*, 947 F.2d 469, 476 (Fed. Cir. 1991); see *Flex-Foot, Inc.*, 238 F.3d at 1369.

182. See *Flex-Foot, Inc.*, 238 F.3d at 1370.

183. See *id.*

184. *Id.*

185. See *id.*

186. See *id.*

187. *Id.* at 1369 (referring to *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348, 349 (Fed. Cir. 1988)).

188. It is more commonly stated that a party to litigation should only get “one bite at the apple.” Randy D. Gordon, *Only One Kick at the Cat: A Contextual Rubric for Evaluating Res Judicata and Collateral Estoppel in International Commercial Arbitration*, 18 FLA. J. INT'L L. 549, 550 n.1 (2006). One commentator even went as far as to say that that a litigant should only get “one kick at the cat.” See *id.*

policy of res judicata trumps the *Lear* doctrine.<sup>189</sup> So far the *Lear* Doctrine is 0-for-3 in allowing challenges to patent validity.<sup>190</sup> In the next section, however, this Note argues that challenges to patent validity must be allowed despite mutual agreement to an NCC at some point before the initiation of litigation.

#### *D. Parties Entering into Licensing Agreement Before Litigation*

The real controversy—and indeed, the circuit split—implicates the enforceability of licensing agreements that are entered into *before* the initiation of any litigation.<sup>191</sup> Imagine, for example, that Martha Stewart capitulates to Lodsys’ offer to sign a pre-litigation licensing agreement that includes an NCC. If litigation somehow breaks out<sup>192</sup> regarding the licensed patent and Stewart breaches the NCC by challenging the patent’s validity in violation of the NCC, that challenge would have a different result depending on the federal circuit in which the challenge was brought. The Second Circuit would extend the *Lear* doctrine to void the pre-litigation NCC.<sup>193</sup> The Federal Circuit, on the contrary, would enforce the pre-litigation NCC as long as it is clear and unambiguous.<sup>194</sup> Although there is currently a circuit split regarding the enforceability of NCCs entered into before litigation begins, courts agree that the issue boils down to a balancing act of competing interests.<sup>195</sup>

*1. Federal Circuit Approach: Off with King Lear’s Head.*—In 2010, the Federal Circuit revealed its willingness to enforce pre-litigation NCCs under certain circumstances in a case called *Baseload Energy, Inc. v. Roberts*.<sup>196</sup> In *Baseload*, Bryan Roberts (the “licensor”) held a patent to a flying wind turbine that resembled a kite.<sup>197</sup> The licensor eventually entered into a joint business venture with David Resnick (the “licensee”), a venture capitalist interested in wind energy projects.<sup>198</sup> As part of that venture, the licensor licensed the patent rights in the turbine to the licensee.<sup>199</sup> Unfortunately, their business relationship

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189. See *Flex-Foot, Inc.*, 238 F.3d at 1370.

190. See *id.*; *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 174 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013); *Foster v. Hallco Mfg. Co., Inc.*, 947 F.2d 469, 483 (Fed. Cir. 1991).

191. See *Rates Tech. Inc.*, 685 F.3d at 170; *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1363-64 (Fed. Cir. 2010).

192. Litigation could break out for a variety of reasons. Stewart could bring a declarative action suit asserting the invalidity of Lodsys’ patent on the grounds that Lodsys was not the first to invent it. See *Lear, Inc. v. Adkins*, 395 U.S. 653, 659 (1969). Lodsys could bring a patent infringement suit against Stewart seeking to enjoin her from producing a new app, and Stewart could allege patent invalidity as a defense. See Magliocca, *supra* note 96, at 1814 n.20.

193. *Rates Tech. Inc.*, 685 F.3d at 174.

194. *Baseload*, 619 F.3d at 1363.

195. *Rates Tech. Inc.*, 685 F.3d at 167-68.

196. See *Baseload*, 619 F.3d at 1357.

197. *Id.* at 1358.

198. *Id.*

199. *Id.*

crumbled, and the licensee sued the licensor for breach of contract.<sup>200</sup> The parties entered into an expansive settlement agreement that provided, *inter alia*, that the licensee releases the licensor “of and from any and all losses, liabilities, claims, expenses, demands *and causes of action of every kind and nature.*”<sup>201</sup> The licensee, however, was not apparently intimidated by this settlement agreement’s apparent preclusion of a subsequent lawsuit.<sup>202</sup> When the licensee ran out of funds to pay the licensing fees, he brought a declaratory judgment action against the licensor, alleging that the turbine’s patent was invalid and unenforceable.<sup>203</sup> Predictably, the licensor moved for summary judgment on the grounds that the settlement agreement precluded the licensee from bringing a cause of action “of every kind and nature,” including one challenging the turbine patent’s validity.<sup>204</sup>

The court allowed the licensee to challenge validity in the suit notwithstanding the NCC.<sup>205</sup> Even though the agreement at stake in *Lear* did not contain an NCC, the court imported *Lear*’s balancing act analysis.<sup>206</sup> On one hand, the court noted that it could promote settlement and efficient resolution of litigation by enforcing the licensing agreement’s NCC.<sup>207</sup> On the other hand, the court held that the licensor could not rely on a pre-litigation licensing agreement to seal his monopoly on a potentially invalid patented turbine.<sup>208</sup> The doctrine of *res judicata* is of no use to the licensor because the NCC in question had never been the subject of litigation.<sup>209</sup>

In dicta, however, the court weakened the central holding of *Lear* by suggesting a way that, *hypothetically*, an NCC could be enforceable.<sup>210</sup> The court relied on its rationale in *Foster v. Hallco Manufacturing Company, Inc.*—a case involving a consent decree—to state that a licensing agreement’s NCC may be enforceable as long as its language is “clear and unambiguous.”<sup>211</sup> Unfortunately, the *Baseload* court offered very little guidance as to what it would take for an NCC to be “clear and unambiguous.”<sup>212</sup> In the most pertinent part of the decision, the court specifically noted that a “clear and unambiguous” NCC would contain “specific language . . . making reference to invalidity issues,” and the court held that the NCC in question did not satisfy that standard.<sup>213</sup>

This dictum regarding the enforceability of NCCs is not persuasive and

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200. *Id.* at 1359.

201. *Id.* (emphasis added).

202. *See id.* at 1360.

203. *Id.*

204. *Id.*

205. *Id.* at 1358.

206. *Id.* at 1361.

207. *Id.*

208. *Id.* at 1364.

209. *Id.* at 1363.

210. *See id.* at 1361-62.

211. *Id.* (relying on *Foster v. Hallco Mfg. Co.*, 947 F.2d 469 (Fed. Cir. 1991)).

212. *See id.* at 1362-64.

213. *Id.* at 1363.

should not be adopted in future cases. How, one might ask, did the court come to derive the specific rule that “clear and unambiguous” NCCs must be enforced? Apparently, the court figured that because consent decrees are enforceable as long as they are clear and unambiguous, licensing agreement NCCs must be enforceable as long as they are clear and unambiguous as well.<sup>214</sup> This reasoning, though, is unsound.

Without more, the fact that the court held in a different case that consent decrees are sometimes enforceable does not mean that the *Baseload* court should rule that pre-litigation licensing agreements are sometimes enforceable too. Mid-litigation consent decrees and pre-litigation licensing agreements are two very different deals brokered at two very different points in the life of a patent dispute.<sup>215</sup> The main reason that consent decrees were held enforceable was that the extraordinarily powerful policy of res judicata tips the *Lear* balance in favor of estoppel.<sup>216</sup> Pre-litigation licensing agreements, however, have absolutely nothing to do with res judicata.<sup>217</sup> Therefore, the *Baseload* court could not rely *exclusively* on the case involving a consent decree, as it did, to support its dictum.<sup>218</sup> The equities underlying pre-litigation licensing agreements simply cannot outweigh the equities associated with patent validity challenges. Lacking further substantiation, *Baseload*’s pro-NCC argument must bow to *Lear*’s maxim that “removing restraints on commerce caused by improperly-held patents should be considered more important than enforcing promises between contracting parties.”<sup>219</sup> In short, the *Lear* doctrine survived the *Baseload* ruling but, as a most unfortunate result of the Federal Circuit’s dictum, the doctrine did not escape unscathed.<sup>220</sup>

2. *Second Circuit Approach: All Hail to King Lear.*—The Federal Circuit Court of Appeals is not the only court to weigh in on the subject of estoppel in patent licensing.<sup>221</sup> In 2012, the Second Circuit handed down an opinion in *Rates Tech., Incorporated v. Speakeasy, Incorporated*, which conflicted with the Federal Circuit’s ruling in *Baseload*.<sup>222</sup> At stake in *Rates*, just as in *Baseload*, was a pre-litigation licensing agreement.<sup>223</sup> Rates Technology Inc. (“RTI”) owned two patents for inventions that pertained to the automatic routing of telephone calls.<sup>224</sup> When RTI noticed that a telecommunications company called Speakeasy was potentially infringing those patents, RTI (the licensor) offered to

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214. *Id.*

215. See Taylor, *supra* note 17, at 240 n.168.

216. *Id.*

217. See Roper, *supra* note 128, at 1651 n.22.

218. See *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1357 (Fed. Cir. 2010).

219. *Warner-Jenkinson Co. v. Allied Chem. Corp.*, 567 F.2d 184, 188 (2d Cir. 1977).

220. See *Baseload*, 619 F.3d at 1357.

221. See *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 163 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013).

222. *Id.* at 173-74.

223. *Id.* at 172.

224. *Id.* at 165.

license Speakeasy (the licensee) the right to use its patents for a one-time fee of \$475,000.<sup>225</sup> The companies entered into a pre-litigation licensing agreement, which contained an extremely specific NCC that stated, *inter alia*, that “Speakeasy will not anywhere in the world challenge . . . the validity of any of the claims of [RTI’s] Patents.”<sup>226</sup> In the event of breach, the agreement provided for liquidated damages on the order of \$12 million.<sup>227</sup> As fate would have it, and just like the licensee in *Baseload*, Speakeasy filed an action for a declaratory judgment that RTI’s patents were invalid and unenforceable.<sup>228</sup>

Like the Federal Circuit in *Baseload*, the Second Circuit held the pre-litigation NCC unenforceable.<sup>229</sup> The difference, however, lies in the fact that the Second Circuit held that a pre-litigation NCC is void and unenforceable *on its face*.<sup>230</sup> That is to say, the Second Circuit did not bother writing dicta suggesting creative ways in which licensors might draft enforceable NCCs.<sup>231</sup> The court here based its pro-licensee holding on *Lear*’s principle that discovering invalid patents is a goal superior to avoiding high cost patent litigation.<sup>232</sup> Again, RTI could not hide behind the shield of *res judicata* because the validity of its patents had not been tested on the battlefield of litigation.<sup>233</sup> Thus, none of the *Flex-Foot* factors applied.<sup>234</sup> The parties had never before conducted discovery on validity issues and the licensing agreement had never received the imprimatur of a court.<sup>235</sup> Furthermore, the Second Circuit expressly rejected the dicta in *Baseload*.<sup>236</sup> Unlike the vague release of “any and all . . . claims” at stake in *Baseload*,<sup>237</sup> the NCC in *Rates* was an incredibly specific agreement not “to challenge[ ] the validity of any of the claims of the *Patents*” in particular.<sup>238</sup> Thus, although the *Rates* NCC “clear[ly] and unambiguous[ly]” purported to prevent challenges of

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225. *Id.*

226. *Id.* In full, the NCC read as follows: “Speakeasy hereby warrants and represents to RTI that on and after the execution date of this Covenant Speakeasy will not anywhere in the world challenge, or assist any other individual or entity to challenge, the validity of any of the claims of the Patents or their respective foreign counterpart patents applications, except in defense to a Patent infringement lawsuit brought under the Patents against Speakeasy, its [products and services], except as otherwise required by law.” *Id.*

227. *Id.*

228. *Id.* at 166.

229. *Id.* at 174.

230. *See id.*

231. *See id.* at 163.

232. *Id.* at 172.

233. *See id.*

234. *See id.*; *see also* *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1370 (Fed. Cir. 2001).

235. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 167 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013).

236. *Id.* at 173-74.

237. *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1362 (Fed. Cir. 2010).

238. *Rates Tech. Inc.*, 685 F.3d at 165 (emphasis added).

the patent's validity, the court held that it could not accomplish that purpose.<sup>239</sup> Although the *Rates* court justified its decision to decline *Baseload's* invitation on the fact that *Baseload's* rationale was dicta, there are additional reasons to abandon *Baseload*.<sup>240</sup> These arguments will be expounded, and their rebuttals addressed, in the next section, which addresses the circuit split by arguing in favor of holding pre-litigation NCCs unenforceable *per se*.

#### IV. RESOLVING THE CIRCUIT SPLIT IN FAVOR OF KING *LEAR*

A fault line, therefore, has ripped through American patent licensing agreement jurisprudence. On one side, the Federal Circuit in its *Baseload* dicta clutches to the notion that NCCs generated pre-litigation may be enforceable if they are "clear and unambiguous."<sup>241</sup> On the other side, the Second Circuit in *Rates* and the Ninth Circuit in *Massillon* hold that pre-litigation NCCs are always unenforceable.<sup>242</sup> In 2013, the U.S. Supreme Court had an opportunity to resolve this circuit split when it encountered a petition for writ of certiorari for the Second Circuit's decision in *Rates*.<sup>243</sup> The Court, however, denied that petition with no comment, thereby leaving the issue unsettled.<sup>244</sup>

##### A. How Should the Circuit Split Be Addressed?

In a duel between *Rates* and *Baseload's* dicta, *Rates* should carry the day. That is to say, a court should not enforce a pre-litigation NCC even when that NCC is "clear and unambiguous." At the outset, it should be noted that *Rates* was not a pioneer in stretching the *Lear* doctrine to hold pre-litigation NCCs unenforceable.<sup>245</sup> As early as 1971, just two years after *Lear* was handed down, the Ninth Circuit had already extended *Lear's* logic to hold pre-litigation NCCs unenforceable.<sup>246</sup>

The first basis for holding pre-litigation NCCs unenforceable comes from *Lear* itself. Certainly, in some situations, it is important to hold licensees to the "technical requirements" of contract law.<sup>247</sup> When set against each other, however, the interest in enforcing contracts must yield to the superior interest in guarding the public domain from invalid patents.<sup>248</sup> Property within the public

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239. *Id.* at 173-74.

240. *Id.* at 173.

241. *Baseload*, 619 F.3d at 1363.

242. *Rates Tech. Inc.*, 685 F.3d at 174; *see Massillon-Cleveland-Akron Sign Co. v. Golden State Adver. Co.*, 444 F.2d 425, 427 (9th Cir. 1971).

243. *Rates Tech. Inc. v. Speakeasy, Inc.*, 133 S. Ct. 932 (2013).

244. *Id.*

245. *See Massillon-Cleveland-Akron*, 444 F.2d 425.

246. *Id.* at 427. *Massillon* also held that the enforceability of pre-litigation agreements containing NCCs should not turn on whether the contract is referred to as a "settlement agreement" or "licensing agreement." *Id.*

247. *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).

248. *Id.*

domain should not be susceptible to being contracted away by a private party who lacks valid ownership of that property. Likewise, an individual should not be able to legally license the rights to an invention if that individual does not hold a valid patent in the invention. And, certainly, if a licensing agreement is entered into and the licensee seeks to challenge<sup>249</sup> the patent's validity, he should not be barred from doing so.

There is at least some support for the proposition that *Lear* does not even apply to the context of pre-litigation NCCs.<sup>250</sup> As several commentators correctly point out, *Lear* allowed a licensee to renege on a licensing agreement that *did not expressly include an NCC*.<sup>251</sup> That is to say, the licensing agreement in *Lear* did not contain an absolute requirement that the licensee never challenge the gyroscope patent's validity.<sup>252</sup>

The fact that *Lear* lacked an NCC, however, is not material.<sup>253</sup> The important fact in *Lear* is that the licensing agreement contained a clause that, like an NCC, provided extremely limited circumstances under which the licensee could terminate the agreement.<sup>254</sup> The clause provided that the licensee could terminate the agreement only if the USPTO refused to grant the pending patent application or if the patent was subsequently declared invalid.<sup>255</sup> Therefore, the agreement operated like an NCC in the sense that it could not be terminated on the basis of a validity challenge unless either of the two conditions was met.<sup>256</sup> When neither of the two conditions was met and the licensee terminated the agreement and challenged the patent anyway, the Court held that the challenge was properly

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249. As a practical matter, licensees do not have problems acquiring standing to challenge the validity of the licensed patent. In 2007, the U.S. Supreme Court ruled that a licensee is able to establish standing to bring a declaratory judgment action challenging validity *even if the licensee does not cease making royalty payments* under the licensing agreement. *Medimmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 136 (2007) (holding that a licensee is “not required . . . to break or terminate its . . . license agreement before seeking a declaratory judgment in federal court that the underlying patent is invalid, unenforceable, or not infringed”). Therefore, post-*Medimmune*, a licensee incurs much less risk in challenging the PAE licensor's patent because the licensee does not have to breach the agreement before litigation, which would otherwise leave him vulnerable to liquidated damages and other penalties. Alex S. Li, *Accidentally on Target: The Mstg Effects on Non-Practicing Entities' Litigation and Settlement Strategies*, 28 BERKELEY TECH. L.J. 483, 513-14 (2013).

250. Melissa Brenner, *Slowing the Rates of Innovation: How the Second Circuit's Ban on Nochallenge Clauses in Pre-Litigation Settlement Agreements Hinders Business Growth*, 54 B.C.L. REV. E-SUPPLEMENT 57, 65 (2013).

251. M. Natalie Alfaro, *Barring Validity Challenges Through No-Challenge Clauses and Consent Judgments: Medimmune's Revival of the Lear Progeny*, 45 HOUS. L. REV. 1277, 1287-88 (2008); Brenner, *supra* note 250, at 62.

252. *See Lear*, 395 U.S. at 657-58.

253. *Id.*

254. *See id.* at 657.

255. *Id.*

256. *Id.*

brought.<sup>257</sup> Therefore, *Lear's* holding confirms that pre-litigation NCCs are unenforceable, and the full force and precedential value of *Lear* must be imported to the balancing act concerning such NCCs.<sup>258</sup> If one would like to argue, as did the Federal Circuit in *Baseload*, that pre-litigation NCCs are enforceable under certain circumstances, then one must disregard the spirit of *Lear*. Many courts, nevertheless, have wisely chosen to recognize *Lear's* applicability to NCCs.<sup>259</sup>

The second basis for holding pre-litigation NCCs unenforceable comes from the fact that doing so would not unreasonably damage judicial economy. Granted, it is a safe bet that enforcing NCCs embedded in pre-litigation settlement agreements would streamline patent lawsuits to some extent.<sup>260</sup> Again, promoting settlement is an enormously important goal of patent law.<sup>261</sup> As Judge Posner articulated, “[t]he general policy of the law is to favor the settlement of litigation, and the policy extends to the settlement of patent infringement suits.”<sup>262</sup> Even though, by definition, litigation has not formally commenced at the time a pre-litigation licensing agreement is reached, the avoidance of litigation is sometimes the motivation for the parties’ decision to include the licensing agreement.<sup>263</sup>

Regardless, there are at least three reasons why the value of judicial economy is not strong enough to compel a rule holding pre-litigation NCCs enforceable. First, just because licensing agreements are sometimes motivated by the desire to avoid litigation does not mean that all of their clauses, no matter how destructive of the values of patent law, must be honored. Judicial economy is important, but it is not of *paramount* importance when private actors (i.e., licensors) threaten to appropriate inventions within the public domain. Again, licensees may be among the few individuals who are sufficiently motivated to challenge the licensors of potentially invalid patents.<sup>264</sup> After all, by buying a license to a patent, licensees have proved themselves economically interested in the invention.<sup>265</sup> Also, licensees are arguably more familiar with related inventions in the field, and this familiarity is essential to the ability to make an informed decision regarding whether to challenge patent validity.<sup>266</sup>

Second, judicial economy is still preserved by the fact that NCCs should still be enforceable under certain circumstances in three situations—namely, mid-

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257. *Id.* at 674.

258. *Server & Singleton*, *supra* note 151, at 408.

259. *Panther Pumps & Equip. Co. v. Hydrocraft, Inc.*, 468 F.2d 225, 231 (7th Cir. 1972); *Massillon-Cleveland-Akron Sign Co. v. Golden State Adver. Co.*, 444 F.2d 425, 427 (9th Cir. 1971); *Bendix Corp. v. Balax, Inc.*, 421 F.2d 809, 821 (7th Cir. 1970).

260. *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1361 (Fed. Cir. 2010).

261. *Asahi Glass Co. v. Penetech Pharms., Inc.*, 289 F. Supp. 2d 986, 991 (N.D. Ill. 2003) (Posner, J., sitting by designation).

262. *Id.*

263. *See Massillon*, 444 F.2d at 425.

264. *See Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).

265. *See id.*

266. *Taylor*, *supra* note 17, at 224.

litigation settlement agreements, consent decrees, and final judgments after litigation on the merits.<sup>267</sup> Unsurprisingly, there is little disagreement among the courts that NCCs are preclusive when entered into during those situations.<sup>268</sup> In those mid- and post-litigation agreement situations, the concern about the negative effects of silencing licensees is attenuated. True, licensees who are involved in litigation regarding patents are probably relatively motivated to challenge patent validity.<sup>269</sup> But, after the initiation of litigation, licensees have the opportunity to conduct discovery about the validity of the licensor's patent.<sup>270</sup> Therefore, licensees can make an *informed* decision regarding whether to sign an enforceable NCC. Finally, the concern regarding judicial economy is somewhat misguided because patent-holding licensors are protected by a presumption of validity in civil litigation.<sup>271</sup> Thus, even if pre-litigation NCCs are not preclusive, a licensee still might be deterred from initiating litigation by the fact that patents, once issued, are entitled to a presumption of validity.<sup>272</sup>

The third reason for denying the preclusiveness of pre-litigation NCCs is that such preclusiveness opens the door to abuse of the patent law system itself. It is important to remember that when patent holders send settlement demand letters to potential infringers, the patent holders are claiming—either indirectly or not-so-indirectly—that they can successfully hit the letter's recipient with a lawsuit rooted in a patent statute.<sup>273</sup> For example, when Lodsys sent a settlement demand to Martha Stewart in the summer of 2013, Lodsys implied that Stewart was infringing its iPad app patent under federal law.<sup>274</sup> Essentially, these patent holders are relying on the patent law system to make their litigation threats credible *even when their patents are invalid*.<sup>275</sup> To even the playing field, patent licensees should have the option of challenging patent validity prior to litigation.

One might argue that if courts hold pre-litigation NCCs unenforceable and mid-litigation NCCs enforceable, then licensors seeking to make their NCCs enforceable will unnecessarily undertake “the formality—perhaps even the charade—of filing an infringement action” to seal the deal.<sup>276</sup> This is an interesting and imaginative concern, but not a substantial one. It is unlikely that parties to a patent dispute will go out of their way to undertake costly discovery for the sole purpose of reaching a settlement agreement that contains a binding NCC.<sup>277</sup> On a related note, one might argue that if courts establish a rule that pre-

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267. *See Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 169-71 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013).

268. *See id.*

269. Taylor, *supra* note 17, at 224.

270. Roper, *supra* note 128, at 1651.

271. 35 U.S.C. § 282 (2012).

272. *See id.*

273. The United States Patent and Trademark Office, *supra* note 57.

274. *See Lee, supra* note 1.

275. The United States Patent and Trademark Office, *supra* note 57.

276. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 173 (2d Cir. 2012).

277. *See id.*

litigation NCCs are unenforceable, then licensees will take advantage of licensors by entering into NCCs without any intention of respecting the NCC. This argument ignores the fact that, in reality, licensors will be privy to the new rule as well. Therefore, licensors will not rely on the notion that such NCCs may be enforced in litigation. More to the point, this argument basically laments the fact that licensors would rely less on NCCs, but that is precisely the objective advocated by this Note.

*B. New Ways to Exterminate Bad Patents Under the America Invents Act*

Although one might argue that holding pre-litigation NCCs unenforceable is unnecessary in light of alternative modes of challenging patent validity, those alternative modes are inadequate to the task. A comprehensive explanation of the two most prominent avenues—inter partes review and post-grant review—would fall beyond the scope of this Note.<sup>278</sup> It is appropriate, however, to evaluate how well these mechanisms can alleviate the problem of licensee estoppel in patent disputes and to see why they fall short.

On September 16, 2011, the America Invents Act (AIA) was enacted.<sup>279</sup> The AIA facilitates challenges to a patent's validity through inter partes review and post-grant review.<sup>280</sup> Basically, either route can be utilized by anyone other than the patent holder.<sup>281</sup>

One might argue that it is unnecessary to afford patent challengers the ability to ignore pre-litigation NCCs because these AIA procedures already provide formidable weapons. Indeed it cannot be disputed that the AIA procedures provide patent challengers a more favorable burden of proof for establishing invalidity. Specifically, a patent validity challenger in either inter partes review or post-grant review has to prove invalidity only by a preponderance of the evidence.<sup>282</sup> This burden stands in stark contrast with the clear and convincing evidence standard that applies to any patent licensee who challenges validity in civil litigation.<sup>283</sup> Still, the fact that some individuals might find it relatively easy to attack a patent's validity using inter partes or post-grant review does not mean that a pre-litigation NCC should estop a licensee from attacking a patent's validity.

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278. For a detailed explanation of inter partes and post-grant review, see D. Christopher Ohly, *The America Invents Act: USPTO Implementation—Inter Partes and Post-Grant Review*, 45-OCT MD. B.J. 4 (2012). For example, these procedures entail different timing requirements, different grounds for invalidity, different fees, different availability of discovery, etc. *See id.*

279. Leahy-Smith America Invents Act, Pub. L. No. 112-29, § 125 Stat 284 (2011).

280. *Id.*

281. *See* 35 U.S.C. §§ 311(a), 321(a) (2012).

282. *Id.* at §§ 316(e), 326(e).

283. *See* *Microsoft Corp. v. i4i Ltd. P'ship*, 131 S. Ct. 2238, 2242 (2011). The "clear and convincing" burden of proof does not have a statutory basis, but it was confirmed in a U.S. Supreme Court decision rendered in 2011. *See id.*

The primary reason for this is mentioned in *Lear* itself.<sup>284</sup> Patent licensees are often the only persons sufficiently motivated to challenge patent validity,<sup>285</sup> but if NCCs are enforceable, then the new AIA procedures are unavailable to those licensees. To avoid a challenge under inter partes review or post-grant review, a licensor could simply fashion an NCC that precludes any type of validity challenge, as did the licensor in *Rates*.<sup>286</sup> Or the licensor could draft an NCC that precludes specific types of validity challenges, including challenges brought under the new AIA procedures. True, inter-partes review and post-grant review are available, in theory, to anyone other than the patent holder.<sup>287</sup> But as Justice Harlan stated in *Lear*, “[l]icensees may often be the only individuals 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.”<sup>288</sup> In other words, because patent licensees usually directly compete with their licensors (hence the licensing agreement), they have a relatively strong interest in challenging the validity of the licensors’ patents.<sup>289</sup> Therefore, the new AIA procedures might well be beneficial, but unless pre-litigation NCCs are held unenforceable, those new procedures are of relatively little use.

#### CONCLUSION

Not only do invalid patents exist, but their owners derive substantial profit from licensing them to others. As Martha Stewart knows all too well, PAEs and other entities frequently offer licensing agreements to others based on vague patents of questionable validity. Relying on the *in terrorem* effect of licensing demand letters, these entities have convinced individuals to pay tribute for using a given invention. Thankfully, however, this unfortunate reality is not unavoidable.

Courts should not go out of their way to establish roadblocks preventing licensees from challenging the patents of their licensors. On the contrary, given the strong rationale in *Lear* and the even stronger rationale in *Rates*, the courts should be paving the way for licensees to challenge patent validity. Specifically, patent licensees should only be prohibited from challenging patent validity when such validity has already been established by a consent decree or final court order or when an NCC has been entered into mid-litigation, after the parties have had an opportunity to conduct discovery. The Federal Circuit, through its dicta in *Baseload*, has attempted to sand the teeth of the *Lear* doctrine by suggesting that NCCs in pre-litigation licensing agreements are enforceable as long as they

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284. See *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).

285. See *id.*

286. See *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 165 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 932 (2013).

287. See 35 U.S.C. §§ 311(a), 321(a) (2012).

288. *Lear*, 395 U.S. at 670.

289. *Id.*

contain “clear and unambiguous” terms. Although not normally the go-to court for patent disputes, the Second Circuit’s decision in *Rates* features the better argument, and should serve as the lodestar by which future courts guide their approach to patent licensing.