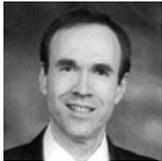


Licensees Can Sue in Federal Court to Resolve Issues Regarding the Scope of a Licensing Agreement Under State Law

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It is not uncommon for parties to a license agreement to find themselves in a dispute regarding the meaning of the terms of that agreement. Questions often arise, however, as to when a party can go to court to resolve such a dispute and what court can properly hear the dispute. For example, if a licensor accuses a licensee of acting outside the scope of the license, must the licensee wait for the licensor to take some action or can the licensee take the initiative and ask a court to decide? Similarly, since license agreements are typically creatures of state law, must those disputes be heard in state court or can they be brought in federal court because the agreements involve federal patent rights?

The United States Court of Appeal for the Federal Circuit recently had the opportunity to address these issues in *ABB Inc., v. Cooper Indus., LLC*, No. 2010-1227 (February 17, 2011).¹ In that case, the Federal Circuit determined that a licensee accused of acting outside the scope of a patent license, and thus infringing the patent, could take the initiative and seek relief in federal court by filing a declaratory judgment action and requesting that the court declare that the licensee's activities did not infringe the patent.

The *ABB* Decision

Cooper Industries had previously sued ABB Industries for patent infringement. The parties settled, entering into a settlement and license agreement where Cooper granted ABB a non-exclusive license under the relevant patents to make, have made, use, have used, offer to sell, export, or have exported ABB's accused "BIOTEMP" product. Despite the apparent grant of "have made" rights, the agreement also explicitly stated that third parties could not make BIOTEMP. After settling the previous litigation, ABB began outsourcing the manufacture of BIOTEMP to Dow Chemicals, agreeing to indemnify Dow against any infringement claims by Cooper.

Cooper subsequently sent a letter to Dow and ABB regarding Dow's manufacture of BIOTEMP. According to Cooper, the "have made" provision of the license agreement did not cover Dow's manufacture of BIOTEMP. In addition, Cooper argued that any attempt by ABB to outsource the manufacture of BIOTEMP would be a material breach of contract, against which Cooper would "vigorously" defend.

ABB then sued Cooper in the U.S. District Court for the Southern District of Texas, seeking a declaration that its activities were

authorized under the license agreement and did not infringe any claim of the relevant patents. Cooper moved to dismiss this declaratory judgment complaint for lack of subject matter jurisdiction on two grounds. First, Cooper argued that there was not an actual controversy surrounding infringement, but rather a dispute only about contract interpretation. Second, Cooper argued that because ABB's only defense to infringement was a state law defense regarding an interpretation of the license agreement, the federal court lacked jurisdiction to hear the case. The district court agreed with Cooper and dismissed the complaint.

On appeal, the Federal Circuit reversed the lower court decision, rejecting both of Cooper's arguments. First, the court found that there was a controversy of "sufficient immediacy and reality" surrounding patent infringement to warrant issuance of a declaratory judgment. Specifically, if ABB were acting outside its license, as Cooper alleged, ABB's liability would have been based on a claim of patent infringement, not breach of contract. The determination of such liability would turn on federal patent law, not state contract law. Thus, an actual controversy existed between the parties regarding question of federal patent law. Moreover, the statements contained in Cooper's letters made the threat of litigation sufficiently immediate so as to warrant declaratory judgment.

Second, the court rejected Cooper's argument that because ABB's only defense to patent infringement was based in state contract law, the controversy did not create a federal question appropriate for federal courts. The Federal Circuit explained that whether a party can rely on a federal question for federal subject matter jurisdiction in a declaratory judgment situation turns on the declaratory judgment defendant's hypothetical cause of action, even if the only defense to that hypothetical cause of action would be rooted in state law. Here, Cooper's hypothetical cause of action was patent infringement, a classic federal question. The subject matter jurisdiction for a declaratory judgment complaint depends only on whether federal law creates the hypothetical cause of action, not whether an issue of federal law would necessarily be the focus of the case.

Strategy and Conclusion

This case can provide insights for patent licensors, patent licensees, and those who draft their agreements:

1. Licensees may ask the federal courts to decide whether they are within the scope of their license agreements.
2. Licensees may sue first and need not wait for the licensor to sue for breach of contract. A licensor's threat of action against the licensee for breach of contract may create sufficient controversy to establish jurisdiction in the federal courts.
3. Licensors should use care in alleging that the licensees breached their agreement. The Supreme Court's decision in *Medimmune v. Genentech* provided that licensees need not breach their license agreement to challenge the validity of the licensed patent. Licensees have similar freedom when it comes to allegations of infringement relating to the scope of the license.
4. Agreement drafters should consider the potential benefit of a forum selection clause. Rather than taking the time to resolve their disputes amicably, parties may rush to file an action for declaratory judgment on their disputes when they want to obtain a preferable venue. This may generate a secondary dispute over which court is appropriate. These situations might be avoided by specifying the venue in advance.

Endnotes

¹ The ABB decision: <http://www.ca9.uscourts.gov/images/stories/opinions-orders/10-1227.pdf>.