

Terminating a License Agreement Precludes Recovering Post-Judgment Royalties Under the Agreement

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A patent license agreement typically permits a licensee to avoid patent infringement liability in exchange for a payment under the license agreement. If a licensee breaches its agreement with a licensor, the licensor can choose one of two remedies: (1) terminate the agreement and sue for patent infringement, or instead, (2) keep the agreement in force and sue for payments due under the agreement.

Electing to proceed by terminating the agreement opens the door to patent infringement damages for past infringement as well as damages for infringement that occurs in the future after the court renders judgment. However, terminating the license agreement—which may be a prerequisite for a finding of infringement—will bar post-termination royalties based on the royalty obligations in license agreement itself. The United States Court of Appeals for the Tenth Circuit recently addressed the issue of post-judgment royalties based on terminated licensing agreements in *Lab. Corp. of America Holdings v. Metabolite Labs., Inc.*, No. 10-1194 (10th Cir. Feb. 2, 2011).¹

The Original *Lab. Corp.* Case

Metabolite licensed several patents and "know-how" relating to assays (or tests) to detect vitamin deficiencies to LabCorp. The license agreement provided terms for voluntary contract termination with respect to a particular licensed assay if a more cost-effective method became available, provided that the new method did not infringe on a licensed patent. LabCorp began using an assay conducted on serum that was developed as an alternative to one of Metabolite's licensed tests, and informed Metabolite that it would no longer pay royalties on that assay when conducted on serum. LabCorp, however, continued to pay royalties for that same assay when conducted on urine, as well as on other licensed assays, pursuant to the license agreement.

Metabolite sued for patent infringement, claiming that the new method infringed a patent licensed under the license agreement. Further, Metabolite argued that the license—with respect to all forms of that assay—was terminated by LabCorp's breach. As such, Metabolite sought patent damages for LabCorp's use of all forms of the assay. As an affirmative defense to the patent infringement

allegation, LabCorp argued that the license agreement, if breached at all, was only partially breached and that it retained a license to use the assay in question. As such, LabCorp argued that Metabolite should only be able to pursue damages under a theory of breach of contract, rather than patent infringement.

After finding the contract was terminated, the jury found that LabCorp had willfully infringed Metabolite's patent and the district court awarded doubled damages based on the jury's willfulness finding. On appeal, the Federal Circuit affirmed and upheld the finding that the license agreement had been terminated. Subsequently, Metabolite filed a post-judgment motion seeking royalties based on the contract.

The *Lab. Corp.* Declaratory Judgment Action

In response to Metabolite's motion, LabCorp filed a new suit seeking a declaratory judgment that it was not liable for post-judgment royalties because the license had been terminated. The district court held that, because of the partial termination of the license agreement, LabCorp did not owe any post-judgment royalties.

Metabolite appealed the decision to the United States Court of Appeal for the Federal Circuit, and because the appeal did not revolve around a question of patent law, the Federal Circuit transferred the case to the Tenth Circuit. The Tenth Circuit noted that the parties had essentially switched positions regarding the effect of LabCorp's behavior on the licensing agreement. The Court held that the jury's finding of infringement was predicated upon termination of the contract. Further, the Court held that having sought and won on the contract termination issue, Metabolite was now estopped from arguing against contract termination in order to recover post-judgment royalties based on the terminated license agreement. That is, having successfully convinced a jury that the license agreement was terminated, the 10th Circuit barred Metabolite from arguing that the license agreement continued to be in force after such termination and that obligations in the agreement should be enforced.

Finally, the Tenth Circuit emphasized that, in pursuing a patent infringement claim against LabCorp under a patent infringement theory, Metabolite could have—but failed to—argue for expected post-judgment income. By not claiming such damages in the prior case, Metabolite was effectively precluded from receiving post-judgment damages under either theory

Strategy and Conclusion

This case serves as a warning for licensors to carefully consider the available remedies when litigating over a breached patent licensing agreement:

1. If a licensee breaches its agreement, the licensor should consider how to enforce its rights, including whether to (1) terminate the agreement, and seek patent infringement damages, thus foregoing damages under the agreement, or (2) keep the agreement in place and recover the damages caused by that breach, thus foregoing patent infringement damages. Aspects to consider include which action would provide a greater recovery, the compensation due under the agreement or damages for infringement, and the relative cost and difficulty in proving liability and damages in a case for breach of an agreement or case for patent infringement.
2. Regardless of whether a licensor elects to proceed under a patent infringement action or a contract action, the licensor should seek post-judgment damages in their proper form—expected post-judgment income in a patent infringement action or royalties under the contract in a breach of contract action.

Endnotes

¹ The *Lab. Corp.* decision: <http://www.ca10.uscourts.gov/opinions/10/10-1194.pdf>.

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