

PATENTS

SPAN-DECK, INC. v. FAB-CON, INC.: DOES A LICENSEE'S MERE CESSATION OF ROYALTY PAYMENTS CONSTITUTE A CHALLENGE TO PATENT VALIDITY?

INTRODUCTION

The doctrine of estoppel arises in the transfer of patent rights in two analogous situations—estoppel of an assignor and estoppel of a licensee.¹ In the assignment of a patent the inventor transfers to the assignee legal title to the patent in exchange for royalties.² If an assignor continues to manufacture the patented invention after an assignment, the assignee may bring an action for infringement.³ A patent license, however, is not a transfer of title.⁴ It only permits the licensee to manufacture, use or sell the patented invention for a royalty, free from any claim of infringement by the inventor.⁵ Furthermore, a patent license is a contractual agreement, the breach of which gives rise to a cause of action under state contract law for nonpayment of royalties.⁶ When suit was brought against the licensee to recover unpaid royalties, courts historically refused to allow the licensee to assert patent invalidity as a defense.⁷ The courts reasoned that the licensee, having accepted the rights and benefits of the patent as consideration, was estopped to deny its validity.⁸ This was known as the doctrine of licensee estoppel.⁹

In *Lear, Inc. v. Adkins*,¹⁰ the United States Supreme Court

1. Comment, *The "Decent Burial" of Patent Licensee Estoppel*, 1970 DUKE L.J. 375, 375.

2. 4 A. DELLER, *DELLER'S WALKER ON PATENTS* § 335 (2d ed. 1965). The underlying premise of the rule of licensee estoppel has provided for the development of an analogous rule of assignor estoppel. Comment, *supra* note 1, at 375. For an example of the rule of estoppel applied in an assignment context, see *Faulks v. Kamp*, 3 F. 898 (C.C.S.D.N.Y. 1880), where the court declared on the basis of fairness that an assignor should not be permitted to sell a patent for valuable consideration, then disregard the agreement by making the invention and argue that the patent sold is invalid. *Id.* at 901.

3. 4 A. DELLER, *supra* note 2, at § 343.

4. *Id.* at § 381.

5. *Id.*

6. *Id.* at § 380.

7. Comment, *supra* note 1, at 376-77. *E.g.*, *United States v. Harvey Steel Co.*, 196 U.S. 310, 317 (1905).

8. 196 U.S. at 317.

9. *Id.*

10. 395 U.S. 653 (1969).

abandoned the doctrine of licensee estoppel, thus permitting licensees to challenge the validity of patents under which they were contractually bound.¹¹ Despite an announcement that public policy necessitated the abrogation of the licensee estoppel doctrine,¹² the Court failed to establish specific guidelines for determining what action constitutes a patent validity "challenge."¹³ This question is important because, under *Lear*, a licensee is justified in discontinuing royalty payments while "challenging" patent validity.¹⁴

Recently the Eighth Circuit Court of Appeals, in *Span-Deck, Inc. v. Fab-Con, Inc.*,¹⁵ addressed the issue of what action by a licensee was sufficient under *Lear* to constitute a challenge to patent validity so as to justify the cessation of royalty payments.¹⁶ This article examines the Eighth Circuit's decision in light of the doctrine of licensee estoppel and the Supreme Court's holding in *Lear*. Furthermore, it addresses the public policy issue upon which further support for the holding is predicated.

BACKGROUND

Patents and Licensing Agreements

Article I, section 8 of the United States Constitution expressly permits patents for the protection of new and useful inventions.¹⁷ Based on this mandate, the Patent Act¹⁸ gives the inventor, for a limited time,¹⁹ an exclusive monopoly with power to make, use, sell or license a patented invention.²⁰ The grant of a patent guarantees the patentee protection against "competition in the practice of the invention."²¹ In exchange for this protection, the disclosure

11. *Id.* at 664, 670-71.

12. *Id.* at 670.

13. Smith, *Foreclosure of Licensee Validity Challenges with Procedural Barriers: Federal Jurisdiction*, 16 IDAHO L. REV. 177, 178 (1980).

14. 395 U.S. at 673-74.

15. 677 F.2d 1237 (8th Cir. 1982).

16. *Id.* at 1245.

17. U.S. CONST. art. I, § 8, cl. 8 provides in pertinent part: "The Congress shall have 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 respective Writings and Discoveries."

18. Act of July 19, 1952, PUB. L. NO. 593, 1952 U.S. CODE CONG. & AD. NEWS (66 Stat.) 792 (codified at 35 U.S.C. §§ 1-293).

19. The term of a patent is seventeen years. 35 U.S.C. § 154 (Supp. V 1981). This section provides that "the patentee, his heirs or assigns . . . [shall have] for the term of seventeen years . . . the right to exclude others from making, using, or selling the invention throughout the United States . . ." *Id.*

20. *Id.*

21. *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661, 665 (1944).

of the patentee's invention is dedicated to the public domain.²² This disclosure must indicate the best available method of carrying out the invention and enable any person skilled in the art²³ to reproduce or make use of the invention.²⁴ Furthermore, the public is protected from the improper issuance of patents by a complex system of standards which must be met before a patent can issue.²⁵ It is in the public interest that the validity of allegedly invalid or questionable patents be adjudicated.²⁶ Although a patent is presumed valid,²⁷ statutory authority exists for establishing invalidity.²⁸ Unlike a patented invention, an unpatented article in the public domain may be freely copied by competitors anxious to profit financially.²⁹

A patentee will often license³⁰ the right to make, use and sell

22. *Scott Paper Co. v. Marcalus Mfg. Co.*, 326 U.S. 249, 255 (1945). In this case the Supreme Court noted:

By the patent laws Congress has given to the inventor opportunity to secure the material rewards for his invention for a limited time, on condition that he make full disclosure for the benefit of the public of the manner of making and using the invention, and that upon the expiration of the patent the public be left free to use the invention.

Id.

23. For purposes of this note, the term "art" is defined as "a given technical area."

24. 35 U.S.C. § 112 (1976). This section provides in pertinent part:

The specification shall contain a written description of the invention, and of the manner and process of making and using it, in such full, clear, concise, and exact terms as to enable any person skilled in the art to which it pertains, or with which it is most nearly connected, to make and use the same, and shall set forth the best mode contemplated by the inventor of carrying out his invention.

Id.

25. 35 U.S.C. § 101 (1976). In order for an invention to be patented, it must be a "new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement." *Id.* An invention may not be patented:

If the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.

Id. at § 103. See also *id.* at §§ 100-104.

26. *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 234 (1892). The Court stated: "It is as important to the public that competition should not be repressed by worthless patents, as that the patentee of a really valuable invention should be protected in his monopoly . . ." *Id.*

27. 35 U.S.C. § 282 (1976) ("A patent shall be presumed valid."); 4 A. DELLER, *supra* note 2, at § 403.

28. 35 U.S.C. § 282 (1976). This section places the burden of establishing patent invalidity on the party asserting it and sets forth the required procedure. *Id.*

29. *E.g.*, *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 231 (1964) ("An unpatentable article, like an article on which the patent has expired, . . . may be made and sold by whoever [sic] chooses to do so."); *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234, 237 (1964) (holding that when an article is unprotected by a patent, state law may not prohibit others from copying it).

30. 4 A. DELLER, *supra* note 2, at § 380. The author notes that patent licenses

the invention to another in exchange for the payment of royalties.³¹ When a license is granted, giving a licensee the right to use a patented invention, that grant is sufficient consideration to support the licensee's promise to make royalty payments.³² In addition, when a licensing agreement is entered into to avoid trademark litigation, the licensor's promise to accept royalty payments instead of profits, and the licensee's promise to pay royalties rather than be held liable for profits, are consideration for each other.³³

The terms of a licensing agreement determine when and under what circumstances royalty payments become due.³⁴ Liability for payment of royalties arises when the licensee exercises rights under the license.³⁵ A noted commentator has observed:

When the license is granted prior to issuance of the patent, the licensor may be entitled to royalties before issuance of the patent, but no royalties can be required on an agreement to grant a license under a patent if the patent is never granted, and where licensor's right to royalties on use of an article is expressly made contingent on issuance of a patent covering such article, he is not entitled to royalties after denial of a patent . . .³⁶

In general, the licensee is liable to the licensor of the patent for any royalties contractually agreed upon during the life of the patent, the expiration of which marks the termination of all liability.³⁷

Doctrine of Licensee Estoppel

Historically, the acceptance of patent rights as consideration in a contractual relationship estopped the party so accepting from

have no statutory basis and whatever rights parties have under a licensing agreement are based on contract. *Id.*

31. *Waterman v. Mackenzie*, 138 U.S. 252, 255 (1891); 4 A. DELLER, *supra* note 2, at § 403. The amount of compensation in a licensing agreement is often termed a "royalty" and is paid by the licensee to the licensor (patent owner) as consideration for the use of a patented invention by the licensee. *Id.*

32. 4 A. DELLER, *supra* note 2, at § 413. See *Lathrop v. Rice & Adams Corp.*, 17 F. Supp. 622, 626 (W.D.N.Y. 1936).

33. 4 A. DELLER, *supra* note 2, at § 413.

34. See *Cold Metal Prods. Co. v. Crucible Steel Co. of America*, 247 F.2d 241, 249 (3d Cir. 1957) (holding that licensor was not entitled to additional royalties because the licensee's operations were not covered by patent during period for which royalties were claimed), *cert. denied*, 355 U.S. 940 (1958).

35. 4 A. DELLER, *supra* note 2, at § 413. See, e.g., *Paris v. Remington Rand, Inc.*, 101 F.2d 65, 65 (2d Cir. 1939) ("It is sufficient . . . [to impose liability] that the invention is used.").

36. 4 A. DELLER, *supra* note 2, at § 413.

37. *Id.*

challenging the validity of the patent.³⁸ This judicial rule was established as early as a century ago in *Kinsman v. Parkhurst*.³⁹ In that case a patent owner granted to licensees the right to manufacture a machine for ginning cotton and wool, and received in return a right to a percentage of their profits.⁴⁰ The licensees breached the contract and justified their actions by declaring that the patent was invalid.⁴¹ The Supreme Court held that since the defendants had manufactured under the plaintiff's title, they were estopped to deny that title in a suit for an accounting of profits.⁴² Thereafter, it became well recognized that the doctrine of estoppel with respect to patent validity was to be applied against the licensee in an action for royalties.⁴³ The rationale supporting the doctrine was that the invalidity of a patent was inconsequential provided the licensee received the rights for which it had bargained.⁴⁴ Since the patent had been used to the licensee's advantage, there was no failure of consideration, and the contract was valid.⁴⁵

If the licensing agreement contained a condition that royalty payments were to cease upon a judicial determination of patent invalidity, the licensee was not permitted to raise invalidity as a defense in a suit for royalty payments unless that judicial determination had already been made.⁴⁶ Courts reasoned that allowing a licensee to assert such a defense would permit it to obtain a premature adjudication of invalidity—which in turn would allow the licensee to escape contractual obligations before there was a fail-

38. See note 1 and accompanying text *supra*.

39. 59 U.S. (18 How.) 289, 293 (1855).

40. *Id.* at 291.

41. *Id.* at 292-93.

42. *Id.* at 293.

43. Note, *Patents-Licensing—Licensee No Longer Estopped to Challenge Patent Validity*, 19 AM. U.L. REV. 282, 284 (1969). See *Marston v. Swett*, 66 N.Y. 206, 211 (1876).

44. 66 N.Y. at 211-12. The court reasoned that under the license agreement: [The licensees] actually enjoyed the exclusive right which they sought, and the plaintiff gave up all right to manufacture or to license others to manufacture. There was no fraud, and the defendants got all they bargained for. [T]hey enjoyed all they could have had if the patent had been valid. [T]here was abundant consideration to uphold the agreement, whether the patent was valid or invalid.

The parties held a patent, which was respected as valid by everybody. They enjoyed a monopoly of the invention. . . . In consideration of defendants' promise, the plaintiff gave up all the advantage he thus had. . .

Id.

45. *Id.* at 213.

46. Note, *supra* note 43, at 284. See *United States v. Harvey Steel Co.*, 196 U.S. 310, 317 (1905). In *Harvey*, the Court reasoned that such a condition "was inserted no doubt, on the assumption that a licensee, when sued for royalties, is estopped to deny the validity of the patent which he has been using, and to give him the benefit of litigation by or against third persons, notwithstanding that rule." *Id.*

ure of consideration.⁴⁷ Thus, absent a prior judicial determination of patent invalidity, the doctrine of estoppel was enforced against the licensee.⁴⁸

Subsequent court decisions began to restrict severely the effects of the doctrine of estoppel, however, and to add a significant degree of confusion to its interpretation.⁴⁹ In *Westinghouse Electric and Manufacturing Co. v. Formica Insulation Co.*,⁵⁰ an assignor, the original patent owner, alleged patent invalidity as a defense in an action for patent infringement brought by the assignee.⁵¹ The Supreme Court refused to apply the estoppel rule, holding that the assignor was not estopped to deny infringement while simultaneously challenging the scope of the patent with evidence tending to show the state of the art.⁵² This challenge was permitted to the extent it did not nullify the patent.⁵³

The Court's decision in *Westinghouse* represented a narrowing of the estoppel doctrine in an assignment application.⁵⁴ The principles restricting the application of the estoppel doctrine were later applied to a license situation in *Casco Products Corp. v. Sinko Tool & Manufacturing Co.*⁵⁵ The Seventh Circuit in *Casco* expanded upon the theory propounded in *Westinghouse*.⁵⁶ It held that although a licensee is estopped to assert that licensed patents *merely follow* teachings of the prior art, the licensee could prove that the patented devices were produced *entirely* according to such teachings because such proof clearly negated the licensor's claim of infringement.⁵⁷ Thus, if the licensee's device had resulted

47. Note, *supra* note 43, at 284.

48. *Id.*

49. *Id.* at 285.

50. 266 U.S. 342 (1924).

51. *Id.* at 344-45.

52. *Id.* at 350-51.

53. *Id.* at 351. The Court noted:

It seems to be well settled that the assignor of a patent is estopped from saying his patent is void for want of novelty or utility, or because anticipated by prior inventions. But this estoppel, for manifest reasons, does not prevent him from denying infringement. . . . The court will not assume . . . anything more than that the invention presented a sufficient degree of utility and novelty to justify the issuance of the patent assigned, and will apply . . . the same rule of construction, with this limitation, which would be applicable between the patentee and a stranger.

Id. (quoting from *Noonan v. Chester Park Athletic Club Co.*, 99 F. 90, 91 (6th Cir. 1900)).

54. See Note, *supra* note 43, at 285.

55. 116 F.2d 119, 121 (7th Cir. 1940).

56. *Id.*

57. *Id.* The Court reasoned that "if everything in [the] defendant's construction was taught by the prior art . . . then the mere fact that the device constructed reads upon the claims of patents, the validity of which it is estopped to deny, does not spell infringement." *Id.*

entirely from the prior art, it was unnecessary to determine the scope of the licensor's patent because there had been no infringement.⁵⁸

In *Scott Paper Co. v. Marcalus Manufacturing Co.*,⁵⁹ the Supreme Court adopted the reasoning of *Casco*.⁶⁰ In *Scott*, the Court declared that the estoppel doctrine could not be applied to deny an assignor the use of an invention when the patent had expired.⁶¹ A dissenting opinion suggested that the Court had in effect, if not literally, repudiated the estoppel doctrine.⁶² This dissent argued that such a decision hindered fair dealing by precluding the enforcement of freely negotiated arms length transactions.⁶³

Despite the emerging trend toward restricting the application of the estoppel doctrine,⁶⁴ the Supreme Court in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*,⁶⁵ stated that as a general rule the licensee still could not challenge the validity of a licensed patent in an action for royalties based on contract.⁶⁶ The Court's declaration revitalized the licensee estoppel doctrine in spite of the earlier judicially-declared exceptions limiting its appli-

58. *Id.*

59. 326 U.S. 249 (1945).

60. *Id.* at 252, 257-58. See also Note, *supra* note 43, at 286.

61. 326 U.S. at 254. The Court stated that:

[t]he patent laws preclude the patentee of an expired patent and *all others* . . . from recapturing any part of the former patent monopoly; for those laws dedicate to all the public the ideas and inventions embodied in an expired patent. They do not contemplate that anyone by contract or any form of private arrangement may withhold from the public the use of an invention for which the public has paid by its grant of a monopoly and which has been appropriated to the use of all.

Id. at 256-57 (emphasis added).

62. *Id.* at 263 (Frankfurter, J., dissenting).

63. *Id.*

64. Note, *supra* note 43, at 287. See also *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173 (1942). In *Sola*, a disputed license contract contained a price-fixing clause which, except for patent protection, would have violated the Sherman Antitrust Act. *Id.* at 175. As a defense to the licensor's suit to enforce this clause, the licensee alleged that the patent was invalid. *Id.* at 174. The Court allowed this challenge, viewing it as an exception to the doctrine of estoppel. *Id.* at 176. The Court held that the public interest against price fixing would be unjustly burdened if a licensee were precluded from asserting the illegality of the contract by establishing patent invalidity. *Id.* at 177. This "anti-trust exception" was predicated on the theory that if price-fixing was to be allowed under patent policy, the Court should be assured that a valid patent exists. Treece, *Licensee Estoppel in Patent and Trademark Cases*, 53 IOWA L. REV. 525, 538 (1967). Subsequent decisions broadened the "anti-trust exception." Note, *supra* note 43, at 286. See, e.g., *Edward Katzinger Co. v. Chicago Metallic Mfg. Co.*, 329 U.S. 394, 398 (1947) and its companion case, *MacGregor v. Westinghouse Elec. & Mfg. Co.*, 329 U.S. 402, 407 (1947).

65. 339 U.S. 827 (1950).

66. *Id.* at 836.

cability.⁶⁷ Thus prior to the Court's decision in *Lear*,⁶⁸ courts were generally unable to clarify within discernible guidelines the appropriate application of the doctrine of licensee estoppel.⁶⁹

Lear, Inc. v. Adkins

Adkins, an engineer and inventor, was employed by Lear under a contract providing that Adkins would have title and control over his own inventions, but would grant Lear a license to use them on a royalty basis.⁷⁰ In 1954, Adkins filed a patent application for an improved gyroscope which he had invented while in the employ of Lear.⁷¹ In 1955, prior to the issuance of the patent, the parties entered into a licensing agreement covering the use of the gyroscope.⁷² After execution of this agreement, but prior to the issuance of the patent, Adkins left Lear's employ.⁷³ Lear then unilaterally terminated the license agreement and refused to make further royalty payments.⁷⁴ Lear was convinced that the invention would never be granted a patent.⁷⁵

The patent on the improved gyroscope was issued in 1960.⁷⁶ Shortly thereafter, Adkins instituted suit for back royalty payments in a California superior court.⁷⁷ He alleged that the gyroscopes manufactured by Lear incorporated his patented invention and that Lear's failure to make royalty payments constituted a breach of contract.⁷⁸ Lear attempted to defend by challenging the validity of the patent.⁷⁹ The trial court held that the doctrine of licensee estoppel precluded such a defense, and directed a verdict for Adkins.⁸⁰

67. Note, *supra* note 43, at 287. See notes 49-64 and accompanying text *supra*.

68. 395 U.S. 653 (1969).

69. Smith, *supra* note 13, at 178.

70. 395 U.S. at 655.

71. *Id.* at 657-58.

72. *Id.* at 657. The parties agreed that if

"the U.S. Patent Office refuses to issue a patent on the substantial claims [contained in Adkins' original patent application] or if such a patent so issued is subsequently held invalid, then in any of such events Lear at its option shall have the right forthwith to terminate the specific license so affected or to terminate this entire Agreement . . ."

Id. (quoting from the contract specifying the conditions on which Lear promised to make royalty payments).

73. *Adkins v. Lear, Inc.*, — Cal. App. 2d —, —, 52 Cal. Rptr. 795, 800 (1966).

74. 395 U.S. at 659-60.

75. *Id.*

76. *Id.* at 659.

77. *Id.* at 660.

78. *Id.*

79. *Id.*

80. *Id.* Lear had produced a large number of gyroscopes at its company's plants in Grand Rapids, Michigan (Michigan Gyros) and in California (California

The California District Court of Appeals, however, took a different approach and held that Lear was within his contract rights in terminating royalty obligations in 1959.⁸¹ As to pre-1959 royalty obligations, the court held that Lear was contractually bound to make those payments irrespective of the validity of Adkins' patent.⁸²

On subsequent appeal, the California Supreme Court adopted yet another approach regarding Lear's contractual royalty obligations.⁸³ It rejected the District Court of Appeal's conclusion that the licensing agreement gave Lear the right to terminate any royalty obligation.⁸⁴ The court determined that the 1955 licensing agreement was still effective, and that consequently the doctrine of licensee estoppel precluded Lear from challenging the propriety of the Patent Office's grant.⁸⁵

On appeal to the Supreme Court of the United States, interpretation of the 1955 licensing contract was held to be a matter of state law.⁸⁶ The Court considered only the issue of whether the state court's reliance on the doctrine of licensee estoppel would preclude Lear from challenging the validity of the patent.⁸⁷ The Court first noted that past efforts of both federal and state courts to delineate the applicability of the estoppel doctrine had rendered the status of that doctrine uncertain.⁸⁸ In analyzing the reasons for this uncertainty, the Court discussed the basic conflict in policy involved between contract law and patent law.⁸⁹ Contract law pro-

Gyros). *Id.* at 659-60. When Lear made a patent search and discovered a patent which he believed anticipated Adkins' improvement to the art of gyroscopy, the company refused to make further royalty payments on the Michigan gyros. *Id.* at 659. Royalty payments were continued on the production of California gyros. *Id.* at 659-60. With respect to the California gyros, the trial court held Lear was estopped from challenging the validity of the patent and directed a verdict for Adkins. *Id.* at 660. With respect to the Michigan gyros, the company claimed that there had been no infringement because these gyros were designed and produced independently of Adkins' ideas. *Id.* Although the jury found for Adkins, the trial judge granted Lear's motion for judgment notwithstanding the verdict on the grounds that Adkins' idea had been wholly anticipated by prior art in gyroscopy. *Id.*

81. *Adkins v. Lear, Inc.*, — Cal. App. 2d at —, 52 Cal. Rptr. at 806.

82. *Id.* at —, 52 Cal. Rptr. at 809.

83. See *Adkins v. Lear, Inc.*, 67 Cal. 2d 882, 435 P.2d 321, 64 Cal. Rptr. 545 (1967).

84. *Id.* at —, 435 P.2d at 336, 64 Cal. Rptr. at 560.

85. *Id.* The court also rejected Lear's contention that the Michigan gyros were a natural extension of the prior art. It found partial reliance on Adkins' invention, whether or not the invention complied with the requisite standards necessary for the grant of a patent, therefore reinstating the lower court's jury verdict. *Id.* at —, 435 P.2d at 336-41, 64 Cal. Rptr. at 560-65.

86. 395 U.S. at 662.

87. *Id.* at 661-62.

88. *Id.* at 664-68.

89. *Id.* at 668.

hibits purchasers from repudiating agreements when they later become dissatisfied.⁹⁰ On the other hand, federal patent law insures that the public have access to all ideas unless a valid patent exists to protect those ideas.⁹¹

In attempting to determine an acceptable middle ground between these conflicting policies, the Court contrasted the facts in *Lear* with a typical licensing situation where a patent is licensed after its issuance rather than while the patent application is pending.⁹² The Court found that the equities supporting the licensor did not weigh heavily when balanced against the public's interest in having free access to the use of ideas that are part of the public domain.⁹³ Concomitant with the Court's rationale that the public's right to use inventions not subject to *valid* patents must be safeguarded—despite traditional contract law requirements⁹⁴—the Court reasoned that the licensee might often be the only individual who can champion the public's interest.⁹⁵ Furthermore, allowing the licensee to contest validity would not unduly burden the licensor since its case is buttressed by the presumption that the Patent Office's *ex parte* legal conclusion is correct.⁹⁶ To facilitate such challenges, the Court overruled the doctrine of licensee estoppel.⁹⁷

The Court then addressed the particular factual situation of *Lear* where the licensing agreement was entered into four years prior to the issuance of the 1960 patent.⁹⁸ Adkins claimed that royalties were due before 1960 notwithstanding the validity of the patent, because *Lear* had had privileged access to his ideas.⁹⁹ This claim was remanded to the California Supreme Court for redeter-

90. *Id.*

91. *Id.*

92. *Id.* at 669-71. In a situation where the licensing agreement is entered into *after* the issuance of a patent, the Court recognized that a manufacturer acquires two benefits. The Court noted:

First, by accepting a license and paying royalties for a time, the licensee may have avoided the necessity of defending an expensive infringement action during the period when he may be least able to afford one. Second, the existence of an unchallenged patent may deter others from attempting to compete with the licensee.

Id. at 669.

93. *Id.* at 670-71. For purposes of this article, the term "public domain" refers generally to those ideas which are not afforded any private interest protection.

94. *Id.*

95. *Id.* at 670. The Court viewed the licensee as the most appropriate person to challenge the patentability of an inventor's idea because the licensee may be the only individual spurred by an economic incentive.

96. *Id.*

97. *Id.* at 671.

98. *Id.*

99. *Id.* at 672.

mination.¹⁰⁰ Adkins also claimed, however, that royalties should be paid for the entire seventeen year term of the patent.¹⁰¹ This claim was expressly rejected.¹⁰² The Court, in reaching its decision, applied the public policy underlying the patent laws despite the contractual language of the 1955 agreement.¹⁰³ That agreement had provided that royalties were to be paid until such time as the patent was declared invalid.¹⁰⁴ The Court reasoned that enforcement of such a provision would give the patentee-licensor a tremendous economic incentive to delay the judicial determination of patent validity.¹⁰⁵ The Court refused to sanction such dilatory tactics.¹⁰⁶ The *Lear* decision thus permits a licensee to avoid liability for royalty payments accruing after the issuance of the patent, provided the validity of the patent is successfully challenged.¹⁰⁷ The Supreme Court's holding in *Lear* "unmuzzled licensees"¹⁰⁸ by permitting them to challenge the validity of patents under which they were contractually bound.¹⁰⁹ The Court announced that the public interest in permitting full and free competition in the use of ideas necessitated the abrogation of the doctrine of licensee estoppel.¹¹⁰ Although the Court's decision was based on public policy, it failed to establish procedural or substantive means by which this policy

100. *Id.* at 675. Adkins' claim for those royalties accruing prior to the issuance of the 1960 patent was a difficult question. *Id.* at 674. His claim raised the issue of whether, and to what extent, states may protect owners of *unpatented* inventions who willingly disclose their ideas to manufacturers in exchange for royalties. *Id.* The California Supreme Court failed to address this issue properly, having determined that the estoppel doctrine provided a sufficient answer to all of *Lear's* claims. *Id.* The United States Supreme Court stated: "Thus, we do not know whether the [California State] Supreme Court would have awarded Adkins recovery even on his pre-patent royalties if it had recognized that previously established estoppel doctrine could no longer be properly invoked with regard to royalties accruing during the 17-year patent period." *Id.* at 674-75.

101. *Id.* at 674-75.

102. *Id.*

103. *Id.* at 672-73.

104. *Id.* at 673.

105. *Id.*

106. *Id.* The Court noted that "the cost of prosecuting slow-moving trial proceedings and defending an inevitable appeal might well deter many licensees from attempting to prove patent invalidity in the courts." *Id.*

107. *Id.* at 674. The *Lear* decision repudiating licensee estoppel was retroactively applied since "the public's interest in the elimination of specious patents would be significantly prejudiced if the retroactive effect of today's decision were limited in any way." *Id.* at 674 n.19.

108. See generally Arnold & Goldstein, *Life Under Lear*, 48 TEX. L. REV. 1235, 1239 (1970); Jennings & Bryan, *The Ever Expansive Scope of Lear v. Adkins: Does It Have Limits?*, 59 J. PAT. OFF. SOC'Y 679 (1977); McCarthy, "Unmuzzling" the Patent Licensee: *Chaos in the Wake of Lear v. Adkins*, 45 GEO. WASH. L. REV. 429, 430 (1977).

109. 395 U.S. at 670.

110. *Id.* at 670-71.

could be effectuated.¹¹¹ Consequently, both state and federal courts have sought to establish their own guidelines for determining what constitutes a sufficient "challenge" to patent validity so as to permit a licensee's royalty obligation to terminate.¹¹²

Is License Termination a Precondition to Challenging Patent Validity?

Post-*Lear* decisions have attempted to determine what action by the licensee was necessary to constitute a "challenge" to patent validity. Before discussing what action courts have found sufficient to constitute such a challenge, it is necessary to analyze whether a licensee's termination of the licensing agreement is a condition precedent to that challenge.

A licensee will often prefer to retain the license while challenging the validity of the patent since terminating the licensing agreement and continuing production under the patent would subject the licensee to a patent infringement action by the licensor.¹¹³ Ideally, the licensee would prefer to cease paying royalties, retain the license and continue production during the pendency of its challenge.¹¹⁴ In this way, if the patent should later be held valid, the licensee would have benefited by the continued use of the license.¹¹⁵ Additionally, a licensee who "stands on the license"¹¹⁶ during an unsuccessful challenge is liable only for unpaid royalties.¹¹⁷ On the other hand, if the licensee terminates the license, yet the patent is held valid, it could be held liable for all profits lost by the licensor as a result of the licensee's continued use by the licensor as a result of the licensee's continued use of the invention.¹¹⁸ Therefore, because of the legal consequences of terminating a licensing agreement, the decision of whether to retain the license is a choice which the licensee should be allowed to elect independently.

111. Smith, *supra* note 13, at 178. The Court's decision in *Lear* did not expand federal jurisdiction if such jurisdiction did not previously exist. *Thiokol Chem. Corp. v. Burlington Indus., Inc.*, 448 F.2d 1328, 1330 (3d Cir. 1971), *cert. denied*, 404 U.S. 1019 (1972).

112. Smith, *supra* note 13, at 178.

113. *See, e.g.*, *Ski Pole Specialists, Inc. v. McDonald*, 159 U.S.P.Q. (BNA) 709, 711 (9th Cir. 1968), *vacated on other grounds*, 167 U.S.P.Q. (BNA) 519 (9th Cir. 1969).

114. *Jennings & Bryan, supra* note 108, at 698.

115. *Id.*

116. *Id.*

117. Smith, *supra* note 13, at 185.

118. *Id.* The patent owner shall be compensated for infringement by an amount of damages at least equal to a reasonable royalty. 35 U.S.C. § 284 (1976). A patent owner may recover *only* lost profits, and not the profits which the infringer illegally received. Smith, *supra* note 13, at 185-86.

Although case law predating *Lear* permitted licensees to maintain a patent validity challenge against their licensors prior to the termination of the license,¹¹⁹ federal courts have split since *Lear* in deciding whether a licensee may bring a declaratory judgment action testing validity where the underlying license remains effective.¹²⁰

In *Thiokol Chemical Corp. v. Burlington Industries, Inc.*,¹²¹ the Third Circuit held that lawful termination of a license is a precondition to the licensee's bringing an action to declare a patent invalid.¹²² The court's opinion was the result of a consolidated appeal from two consecutive suits filed in federal district court by a manufacturer-licensee against the owners-licensors of three patents.¹²³ The manufacturer-licensee sought declaratory judgments as to the validity of those patents, and its possible infringement of them.¹²⁴

119. Smith, *supra* note 13, at 186. See, e.g., *American Mach. & Metals, Inc. v. De Bothezat Impeller Co.*, 166 F.2d 535, 537 (2d Cir. 1948) (permitting a licensee to seek a declaratory judgment of patent invalidity while license remained in effect).

120. Smith, *supra* note 13, at 186.

121. 448 F.2d 1328 (3d Cir. 1971), *cert. denied*, 404 U.S. 1019 (1972).

122. *Id.* at 1331. See also Note, *Thiokol Chemical Corp. v. Burlington Industries, Inc.: The Availability of Federal Declaratory Judgments to Licensees Challenging Patent Validity*, 34 U. PITT. L. REV. 43 (1972).

123. *Thiokol Chem. Corp. v. Burlington Indus., Inc.*, 319 F. Supp. 218 (D. Del. 1970); *Thiokol Chem. Corp. v. Burlington Indus., Inc.*, 313 F. Supp. 253 (D. Del. 1970).

124. 448 F.2d at 1330. In 1964, Burlington licensed Thiokol to use three inventions relating to the manufacture of carpet backing. *Id.* The licensing agreement allowed either party to terminate upon 90 days notice. 313 F. Supp. at 254. In 1969, apparently encouraged by the Court's holding in *Lear*, Smith, *supra* note 13, at 187, the licensee stopped paying royalties and brought a declaratory judgment action in federal court to declare the patents invalid. 313 F. Supp. at 253-54. At this time neither party had terminated the license. *Id.* at 254. The district court dismissed the first action. *Id.* at 257. It concluded that a reasonable threat of patent infringement must exist before the jurisdictional requirements for a declaratory judgment can be met. *Id.* at 256. The court stated that the purpose of a license was to protect the licensee against infringement actions. *Id.* at 255. The court held that there were only three factual situations wherein the licensee could be the subject of an infringement action: (1) where the allegedly infringing devices are not covered by the license; (2) where the license has expired; or (3) where the licensee has repudiated the license. *Id.* These criteria were adopted from the Ninth Circuit's decision in *Ski Pole Specialists, Inc. v. McDonald*, 159 U.S.P.Q. (BNA) 709, 711 (9th Cir. 1968), *vacated on other grounds*, 167 U.S.P.Q. (BNA) 519 (9th Cir. 1969). Since none of these factual situations had occurred, the court found that the licensor had threatened no infringement and, therefore, dismissed the case for lack of jurisdiction. 313 F. Supp. at 257.

Subsequent to this dismissal, licensee Thiokol ceased making royalty payments, and pursuant to a clause in the agreement, the license terminated. 448 F.2d at 1231. The licensee then initiated a second declaratory judgment action. 319 F. Supp. at 220. The sole factual difference between this action and the previous one in which the court had held that it lacked jurisdiction was the termination of the licensing agreement. *Id.* Once the agreement was properly terminated, the same court determined that jurisdiction was proper under 28 U.S.C. § 1338(a). 319 F. Supp. at 222-23.

The Third Circuit held: (1) an actual controversy does not arise between a licensee and a licensor until the license has been terminated;¹²⁵ (2) an action does not arise under federal patent laws unless the licensor has charged the licensee with patent infringement;¹²⁶ and (3) by taking jurisdiction over patent infringement actions, a federal court may not interfere with a state court proceeding concerning the payment of royalties.¹²⁷

However, in *American Sterilizer Co. v. Sybron Corp.*,¹²⁸ the Third Circuit implicitly overruled *Thiokol*¹²⁹ without expressly determining whether an actual controversy existed or whether the case was one arising under the patent laws.¹³⁰ The court held that the failure of the licensee to properly terminate the license did not preclude the licensee from attacking the validity of the patent.¹³¹ Furthermore, the licensee was not required to pay royalties during the pendency of the patent validity challenge.¹³² In reaching its decision, the court declared that *Lear* was dispositive.¹³³

In *Warner-Jenkinson Co. v. Allied Chemical Corp.*,¹³⁴ the Second Circuit addressed the same issue.¹³⁵ Reversing the district

125. 448 F.2d at 1331.

126. *Id.* at 1330-31.

127. *Id.* at 1332.

128. 526 F.2d 542 (3d Cir. 1975).

129. Jennings & Bryan, *supra* note 108, at 692.

130. *Id.* Smith, *supra* note 13, at 189. In that case, American Sterilizer, the licensee, brought a declaratory judgment action claiming that its manufacturing process was not embodied in the licensing agreement with Sybron and that the controlling patent was invalid. 526 F.2d at 544. American Sterilizer refused to make royalty payments under the agreement, but did not terminate the license. *Id.* at 546. Sybron, the licensor, filed a counterclaim seeking an accounting of royalties due. *Id.* at 544. The district court entered a judgment for the licensor, holding that the licensee's failure to terminate the license precluded a patent validity challenge. *Id.* at 543.

131. 526 F.2d at 547-48.

132. *Id.*

133. *Id.* at 547. Although the licensor argued that the *Lear* rationale was inapplicable because the licensee in *Lear* was unable to terminate the license by the terms of the agreement, the Third Circuit rejected this argument on the ground that the state court in *Lear* expressly found that *Lear* (the licensee) had failed to terminate the license in accordance with the termination provisions. *Id.* at 546. The agreement in *Lear* and the agreement in *American Sterilizer* both permitted termination, and in both cases the licensees had failed to comply with the termination provisions. Since the facts in both cases were identical, the court determined that the applicability of *Lear* did not depend on the presence of a license termination provision. *Id.*

134. 567 F.2d 184 (2d Cir. 1977).

135. *Id.* at 187. Allied owned patents for the manufacture of red food color known as "Red No. 40." *Id.* at 185. The nation's food industry predominantly used another color additive, Red No. 2, until the Food and Drug Administration banned this product for public health reasons. *Id.* at 186. Warner-Jenkinson then sought a manufacturing license from Allied to use Red No. 40. *Id.* at 185. When Allied refused to grant Warner-Jenkinson the use of the patent, Warner-Jenkinson produced

court, the Second Circuit held that termination of the license cannot constitute a precondition to seeking a declaration of patent invalidity.¹³⁶ The court noted the broad public policies enunciated in *Lear*, stating that requiring termination of a license as a precondition to relief would have a "chilling effect" on patent validity challenges.¹³⁷

As demonstrated by *American Sterilizer*¹³⁸ and *Allied Chemical*,¹³⁹ license termination would not seem to be a precondition to challenging the validity of a patent.¹⁴⁰ During the pendency of a challenge to an allegedly worthless patent, a licensee is thus able to maintain its licensing agreement and to continue production without the threat of an infringement action being initiated against it by the patentee-licensor.¹⁴¹ This result facilitates challenges to worthless patents,¹⁴² and is in keeping with the public policy arguments articulated in *Lear*.¹⁴³ Assuming, therefore, that a licensee need not terminate its license in order to challenge patent validity, it is now necessary to analyze: (1) the nature of the licensee's challenge; and (2) what action under *Lear* is sufficient to constitute such a challenge.

The Licensee's Challenge

A challenge may be defined as an unequivocal act by a licen-

Red No. 40 in defiance of Allied's patent. *Id.* The parties subsequently entered into a licensing agreement as part of a settlement of earlier litigation. *Id.* One of the terms of this agreement made nonpayment of royalties a material breach for which only the licensor could terminate the license. *Id.* at 187. While continuing to pay royalties, Warner-Jenkinson filed an action in federal district court seeking a declaration of patent invalidity. *Id.* The district court held that the licensees, Warner-Jenkinson, were prevented from seeking declaratory relief from liability for the payment of further royalties on the basis of patent invalidity because the licensing agreement was, by its terms, nonterminable. *Id.* at 185.

136. *Id.* at 188. Then the court stated:

If forced to make the hard choice [between terminating the license or paying royalties], many licensees will choose the less perilous course, and the patents under which they are licensed will remain uncontested. *Lear* established that removing restraints on commerce caused by improperly-held patents should be considered more important than enforcing promises between contracting parties. Thus, the seeming inequity of allowing a licensee to keep his license while he attacks the validity of the licensor's patent is outweighed by the public interest in placing no impediment in the way of those in the best position to contest the validity of the underlying patent.

Id. at 187-88.

137. *Id.* at 188.

138. See notes 128-133 and accompanying text *supra*.

139. See notes 134-137.

140. See Smith, *supra* note 13, at 192.

141. See Jennings & Bryan, *supra* note 108, at 694.

142. 395 U.S. at 672.

143. *Id.* at 670.

see evidencing its belief that the patent is invalid.¹⁴⁴ The determination of what comprises a valid challenge under *Lear* presupposes that a final adjudication of invalidity has not yet been rendered by any court.¹⁴⁵

In *Troxel Manufacturing Co. v. Schwinn Bicycle Co.*,¹⁴⁶ the patent licensee brought an action against the licensor to recover previously paid royalties.¹⁴⁷ Schwinn Bicycle, the assignee of a design patent for a bicycle seat, entered into a licensing agreement with Troxel under which Troxel was licensed to manufacture and sell bicycle seats in exchange for the payment of royalties.¹⁴⁸ Schwinn had obligated itself to enforce the patent against subsequent infringers.¹⁴⁹ During the course of this agreement, Troxel notified Schwinn of Fisher Cycle Company's unlicensed manufacture of the patented invention.¹⁵⁰ Schwinn subsequently instituted an infringement action against Fisher's vendee.¹⁵¹ In this action the court declared the patent invalid.¹⁵² As a result of this declaration Troxel informed Schwinn that any royalties due under the licensing agreement would be paid in escrow pending Schwinn's appeal to the Ninth Circuit.¹⁵³ Schwinn subsequently brought suit against Troxel to collect these escrow royalties.¹⁵⁴ Schwinn dismissed this suit when Troxel agreed to continue making royalty payments.¹⁵⁵

When the Ninth Circuit affirmed the previous declaration of patent invalidity, Troxel instituted an action to recover all royalties paid.¹⁵⁶ Based on the facts and reasoning in *Lear*, the lower court granted summary judgment to Troxel.¹⁵⁷ The Sixth Circuit reversed and held that only when the licensee itself actively challenges the validity of the patent does the obligation to pay royalties terminate conditionally with the showing of the patent's

144. McCarthy, *supra* note 108, at 462.

145. *Id.*

146. 465 F.2d 1253 (6th Cir. 1972), *cert. denied*, 416 U.S. 939 (1974).

147. *Id.* at 1253.

148. *Id.* at 1254.

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.* at 1255.

153. *Id.*

154. *Id.*

155. *Schwinn Bicycle Co. v. Goodyear Tire & Rubber Co.*, 444 F.2d 295, 295 (9th Cir. 1970).

156. 465 F.2d at 1255.

157. *Id.* The district court found that "the doctrine of *Lear* would . . . be equally applicable" to the situation in which a licensee asserts patent invalidity offensively to recover royalties already paid. *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 334 F. Supp. 1269, 1271 (W.D. Tenn. 1971).

invalidity.¹⁵⁸ The court reasoned that:

Rather than stimulating early litigation to test patent validity, such an interpretation of *Lear* [allowing the licensee to collect prepaid royalties] would make it advantageous for a licensee to postpone litigation, enjoy the fruits of his licensing agreement, and sue for repayment of royalties near the end of the term of the patent. When a licensed patent is about to expire and the threat of injunction no longer exists, a licensee would have little to lose in bringing an action to recover all the money he has paid in royalties on the ground of the invalidity of the patent.¹⁵⁹

An interpretation of *Lear* that would allow the licensee to sit back and wait for a third party to first challenge the validity of a patent would be inconsistent with the underlying principle of that decision, which was to provide licensees with an incentive to challenge worthless patents.¹⁶⁰ It was generally thought, therefore, that the earliest date a licensee's liability for royalty payments would cease was "the date the licensee filed a declaratory judgment action, or the date the licensee filed an answer to a licensor's suit for non-payment of royalties, wherein the licensee as a defense asserts the patent's invalidity."¹⁶¹

The Sixth Circuit, however, in *PPG Industries v. Westwood Chemical, Inc.*,¹⁶² redefined the criteria for determining the earliest date for termination of the licensee's royalty liability. In 1962,

158. 465 F.2d at 1260. The Sixth Circuit stated that:

The precise holding of *Lear* was that a licensee was not estopped to interpose the invalidity of the licensed patent as a defense to an action brought by the licensor to enforce the license agreement. (citation omitted). [Allowing the licensee to assert] invalidity offensively to recover royalties already paid . . . [is] an unwarranted extension of *Lear*.

Id. at 1255.

159. *Id.* at 1257. Although the patent-licensee in *Troxel* urged that the *Lear* rationale allows the avoidance of royalties on an invalid patent from the time the patent issued and not from the time the patent was held invalid, the Sixth Circuit concluded that neither principles of equity nor public policy would sanction the licensee's recovery of previously paid royalties. *Id.* at 1259-60.

160. *Id.* at 1257. The licensee then brought a second action seeking leave to amend its pleadings in order to assert an alternative theory to avoid liability for the royalty payments. *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 489 F.2d 968 (6th Cir. 1973), *cert. denied*, 416 U.S. 939 (1974). The licensee claimed that leave to amend should be granted because it had misconceived the effect of *Lear*. *Id.* at 970. The Sixth Circuit refused to grant such leave, noting that "a misconception of the law is not an excuse for the late presentation of an alternative theory of recovery." *Id.* at 971. Furthermore, it held that a licensee who did not initiate the patent validity challenge must pay royalties up until the final adjudication of the patent's validity. *Id.* at 973-74.

161. See Jennings & Bryan, *supra* note 108, at 695.

162. 530 F.2d 700 (6th Cir.), *cert. denied*, 429 U.S. 824 (1976).

PPG and Westwood entered into a licensing agreement which included a third party infringement clause.¹⁶³ In 1963, PPG notified Westwood that third parties were infringing the patent and Westwood, pursuant to the agreement, initiated a patent infringement action.¹⁶⁴ During the extensive discovery period, PPG offered Westwood full cooperation in establishing the patent's validity.¹⁶⁵ However, in 1969, dissatisfied with the long delays in bringing the infringement action, PPG ceased paying royalties.¹⁶⁶ PPG neither notified Westwood as to its reasons for nonpayment, nor took affirmative action of any sort.¹⁶⁷ The patent was declared invalid in 1970.¹⁶⁸ In early 1971, PPG brought a declaratory judgment action against Westwood seeking to have its license declared unenforceable because of patent invalidity.¹⁶⁹ Westwood subsequently counterclaimed for unpaid royalties.¹⁷⁰ Judgment was entered for Westwood.¹⁷¹

On appeal to the Sixth Circuit, PPG asserted that the *Lear* rationale permitted a licensee to stop paying royalties and to thereby avoid any royalty liability if the patent was later declared invalid.¹⁷² The court disagreed and held that the licensee must not only cease paying royalties, but must also take some affirmative action which will prompt an early adjudication of the patent's validity.¹⁷³ The court stated:

Under *Lear*, liability for royalties ordinarily is terminated on one of two dates . . . whichever first occurs: (1) on the date the licensee ceases the payment of royalties *for the purpose of prompting an early adjudication of invalidity*; or (2) on the date the licensee files suit (or counter-claim) attacking the validity of the patent.¹⁷⁴

163. *Id.* at 701-02. Under a "third party infringement clause," the licensee must request the licensor to bring suit against a third party infringing the licensed patent. After notifying the licensor of a third party infringement, the licensee is relieved of royalty payments during the period the licensed patents are allegedly infringed until the licensor files an infringement action against the third party. *See id.* at 702.

164. *Id.* at 703.

165. *Id.*

166. *Id.*

167. *Id.*

168. *Westwood Chem., Inc. v. Owens Corning Fiberglass Corp.*, 317 F. Supp. 201, 215 (N.D. Ohio 1970), *aff'd*, 445 F.2d 911 (6th Cir. 1971), *cert. denied*, 405 U.S. 917 (1972).

169. 530 F.2d at 703.

170. *Id.* at 704.

171. *Id.* at 701.

172. *Id.* at 706.

173. *Id.* at 707.

174. *Id.* at 708 (emphasis added).

Because PPG's cessation of royalty payments had not been coupled with appropriate "affirmative action," the court held that the date PPG's declaratory judgment action was filed was determinative of its liability for royalties.¹⁷⁵

The Sixth Circuit's holding in *PPG*, that the licensee's cessation of royalty payments must be coupled with affirmative action which will prompt an early judicial determination of patent validity before the licensee's liability for royalties terminates,¹⁷⁶ seems consistent with *Lear*.¹⁷⁷ Therefore, if a licensee has a reasonable basis for claiming patent invalidity and provides the licensor with notice, the licensee may cease paying royalties and be freed from liability for those payments unless the patent's validity is subsequently sustained in an action by the licensor for royalties.¹⁷⁸ The court's decision in *PPG* thus extended the *Lear* rationale further than any prior case with respect to determining the date on which a licensee may avoid liability for royalty payments.¹⁷⁹

FACTS AND HOLDINGS

Span-Deck is a Tennessee based corporation involved in franchising the use of machinery and a concrete manufacturing process.¹⁸⁰ Between 1965 and 1979, Span-Deck acquired two patents used to facilitate the casting and production of concrete planks reinforced with tensioned steel cables.¹⁸¹

175. *Id.*

176. *Id.*

177. Jennings & Bryan, *supra* note 108, at 697. *Lear, Inc. v. Adkins*, 395 U.S. 653, 673-74 (1969). The Court held that the enforceability of a licensing agreement would be determined by federal policies which would otherwise be frustrated if licensees could be required to continue paying royalties during the period of a patent validity challenge:

It seems to us that such a requirement would be inconsistent with the aims of federal patent policy. Enforcing this contractual provision would give the licensor an additional economic incentive to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning. He can receive no reason to encourage dilatory court tactics in this way. Moreover, the cost of prosecuting slow-moving trial proceedings and defending an inevitable appeal might well deter many licensees from attempting to prove patent invalidity in the courts. . . . If a licensee has reason to believe that he will replace a patented idea with a new one in the near future, he will have little incentive to initiate lengthy court proceedings, unless he is freed from liability at least from the time he refuses to pay the contractual royalties. Lastly, enforcing this contractual provision would undermine the strong federal policy favoring full and free use of ideas in the public domain.

Id.

178. Jennings & Bryan, *supra* note 108, at 697.

179. *Id.*

180. 667 F.2d at 1238.

181. *Id.* at 1238-39. In 1965 Span-Deck obtained the "Kinnard patent" (U.S. Pat-

During the summer of 1970, Rauenhurst, a Minneapolis based construction company, negotiated with Span-Deck with the intention of entering the concrete business.¹⁸² In October 1970, Fabcon, a wholly-owned subsidiary of Rauenhurst, entered into a franchise licensing agreement with Span-Deck.¹⁸³ Under the terms of the agreement, Fabcon was to receive the exclusive right to use two Span-Deck patents as a licensee, as well as the use of machinery, equipment and certain trade secrets.¹⁸⁴ In return, Fabcon tendered \$235,000 plus a "hybrid" royalty¹⁸⁵ as consideration for both the patent and nonpatent rights.¹⁸⁶

In July 1971, Fabcon began commercial production of concrete planks under the franchise licensing agreement and quickly expanded its production operations.¹⁸⁷ In February 1973, Fabcon ceased paying royalties, asserting that a "preferred-licensee" clause of the franchise agreement entitled Fabcon to a credit.¹⁸⁸ In April 1973, Rauenhurst asserted on behalf of Fabcon that Span-Deck's patents were invalid, and unsuccessfully demanded that the franchise licensing agreement be terminated.¹⁸⁹

ent No. 3,217,375) for a casting device used in casting concrete hollow-core slabs. *Id.* at 1238. The patent covered a method of production where a casting machine, *i.e.*, the Kinnard machine, deposited liquid concrete around steel cables that were held together by a preformed mold. *Id.* In 1970 the "Mitchell patent" (U.S. Patent No. 3,523,343) was acquired for a system which incorporated the Kinnard machine into a high-volume concrete production system utilizing movable casting beds. *Id.* at 1239.

182. *Id.*

183. *Id.*

184. *Id.* Span-Deck contracted to furnish casting equipment, casting machinery and specifications; to provide its assistance, experience and trade secrets concerning Span-Deck's manufacturing methods; to permit Fabcon the exclusive right to use the Kinnard and Mitchell patents within a specific geographical area for five years; and to permit Fabcon the exclusive right to use the "Span-Deck" trademarks throughout the term of the franchise agreement. *Id.*

185. *Id.* at 1238-39, 1246.

186. *Id.* at 1246. In addition, Span-Deck granted Fabcon options to extend the duration of the contract for five years and to cease paying any royalties should it be determined that Span-Deck's manufacturing process was not patentable. *Id.* The contract included the following post-termination conditions:

In the event of termination of this Agreement in any manner, LICENSOR shall have the right to complete any and all contracts which it may be obligated to fulfill, paying the royalties thereon, but shall not further use, either directly or indirectly, the trademarks or trade names, any trade secrets or valid, protected patented processes of LICENSOR, or use or employ any imitations of LICENSOR'S trade names, trademarks, or valid, protected patented processes, if acquired during the term of this Agreement; and these obligations shall continue after termination of this Agreement.

Id.

187. *Id.*

188. *Id.*

189. *Id.* After commencing commercial production of concrete planks, Fabcon considered an alternative method of producing an energy efficient product. If Fabcon changed its method of production, such a change would have legal repercus-

In November 1973, Span-Deck brought an action against both Fabcon and Rauenhurst.¹⁹⁰ Span-Deck alleged breach of the licensing agreement by Fabcon, and intentional inducement of the breach by Rauenhurst.¹⁹¹ Span-Deck sought payment of royalties, damages and injunctive relief.¹⁹² Fabcon counterclaimed for a declaratory judgment, asserting that the franchise agreement was invalid or unenforceable due to failure of consideration and that the two patents were invalid, unenforceable and un infringed.¹⁹³

Judgment was entered on a jury verdict of \$1,500,000 in compensatory damages and \$2,000,000 in punitive damages against Fabcon and Rauenhurst respectively.¹⁹⁴ The trial court refused to grant injunctive relief and dismissed Fabcon's counterclaim with prejudice.¹⁹⁵

On appeal to the Eighth Circuit, Fabcon and Rauenhurst contended that the trial court had erred by denying a directed verdict on behalf of Rauenhurst on the tortious inducement claim, arguing that Rauenhurst's actions had been justified.¹⁹⁶ Furthermore, they contested the amount of compensatory damages and asserted that

sions depending on whether or not the new equipment fell within the provisions of the Kinnard and Mitchell patents. If the new machinery used for the alternative manufacturing process fell within the claims of either patent, Fabcon would be afforded protection since the franchise agreement granted Fabcon the right to use the machinery in a specific geographical area; if not, Fabcon would not have any exclusive rights to the alternative manufacturing process. In an effort to protect its contractually-designated exclusive territorial rights, Fabcon sought legal assistance to examine the Mitchell and Kinnard patents. The study authorized by Fabcon revealed that both patents were invalid and that Span-Deck was receiving illegal royalties by monopolizing the production of precast concrete planks through invalid patents. Brief for Appellant at 11, *Span-Deck, Inc. v. Fab-Con, Inc.*, 677 F.2d 1237 (8th Cir. 1982).

190. 677 F.2d at 1239.

191. *Id.*

192. *Id.* Contained within Span-Deck's complaint were the following seven allegations:

Count I of Span-Deck's complaint alleges breach of contract by Fabcon and seeks payment of royalties and injunctive relief. Count II alleges intentional inducement of breach by Rauenhurst and seeks compensatory and exemplary damages. Count III alleges unauthorized use of trade secrets and know-how and seeks compensatory and exemplary damages and injunctive relief. Counts IV and V allege trademark infringement and seek compensatory and exemplary damages and injunctive relief. Counts VI and VII allege patent infringement and seek compensatory and exemplary damages and injunctive relief.

Id. of 1239. Prior to submitting the case to the jury, the allegations of trademark infringement were withdrawn. *Id.* at 1240.

193. *Id.* at 1239.

194. *Id.* at 1240.

195. *Id.* The trial court's judgment was subsequently modified pursuant to the plaintiff's motion to hold Rauenhurst jointly and severally liable for the \$1,500,000 compensatory damage award. *Id.*

196. *Id.*

Span-Deck's patents were invalid as a matter of law.¹⁹⁷ The Eighth Circuit reversed, finding one of the patents invalid and the other un infringed.¹⁹⁸ The court set aside the damage award, based on

197. *Id.* The appellants asserted that the invalidity of the Kinnard and Mitchell patents precluded an award of compensatory damages under *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969). 677 F.2d at 1240. In *Lear*, the Supreme Court held that where a patent licensor seeks to enforce a licensing agreement, a patent licensee can challenge the validity of the patent under which he is contractually obligated to make royalty payments. 395 U.S. at 670-71. Furthermore, a licensee may avoid paying royalties accruing after the issuance of the patent if either the licensee or a third party proves the patent invalid. *Id.* at 673-74.

As to the invalidity of Span-Deck's patents, the appellants first asserted that the Kinnard patent was invalid pursuant to 35 U.S.C. § 102(b), which provides:

A person shall be entitled to a patent unless—

...
 (b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States

677 F.2d at 1240. At trial the jury did not find that the Kinnard patent had been in public use for more than one year prior to the plaintiff's patent application. *Id.* The Eighth Circuit noted, however, that a defendant relying on the "public use or sale" defense of 35 U.S.C. § 102(b) must establish it by clear and convincing evidence. *Id.* at 1240 n.3. See, e.g., *CTS Corp. v. Piher Int'l Corp.*, 593 F.2d 777, 779 (7th Cir.), cert. denied, 444 U.S. 884 (1979); *Amerio Contact Plate Freezers, Inc. v. Belt-Ice Corp.*, 316 F.2d 459, 462 n.7 (9th Cir.), cert. denied, 375 U.S. 902 (1963). Although the jury's verdict failed to determine when the patent application was filed or whether or not the invention was ever "on sale" within the meaning of the statutory language, the court nonetheless found the Kinnard patent valid. 677 F.2d at 1241.

As to the Mitchell patent, Fabcon and Rauenhurst challenged its validity on the grounds of lack of a novel idea and obviousness pursuant to 35 U.S.C. §§ 102 and 103, respectively. 677 F.2d at 1241. Under § 103 a patent will not be issued on a device if it embodies an obvious improvement of the prior art. 35 U.S.C. § 103 (1976). Span-Deck's argument that the Mitchell patent revealed a nonobvious invention which had not earlier been considered in the prior art was based on the claim that the machinery used in the curing process for the commercial production of concrete had a unique configuration. 677 F.2d at 1244. Despite Span-Deck's claim, the court noted that this configuration appeared to effect no more than a change in sequence. *Id.* The court pointed out that the requirements necessary to patent a manufacturing process include more than the mere rearrangement of the steps needed to complete the process. *Id.* See, e.g., *Stephenson v. Brooklyn Cross-Town R.R.*, 114 U.S. 149, 154 (1885) (new combination of separate devices used to open a car door is not patentable); *National Connector Corp. v. Malco Mfg. Co.*, 392 F.2d 766, 770 (8th Cir.) ("differences in configuration only" of electrical connectors are not patentable), cert. denied, 393 U.S. 923 (1968); *Ajax Mfg. Co. v. National Mach. Co.*, 93 F.2d 344, 346 (6th Cir. 1937) (application of rotary motion instead of sliding motion to forging machines is not patentable); *DeBurgh v. Kindel Furniture Co.*, 125 F. Supp. 468, 476 (W.D. Mich. 1954) (improvement of one element of a previously patented combination of old elements in a conveyor system is not patentable), *aff'd*, 229 F.2d 740 (6th Cir.), cert. denied, 352 U.S. 823 (1956).

After reviewing the discernible distinctions between the Mitchell patent and the prior art, the court held that the Mitchell "system" was at best an obvious technological improvement which combined existing equipment and production methods not constituting a patentable invention. 677 F.2d at 1244-45.

198. 677 F.2d at 1249.

the rule of *Lear*,¹⁹⁹ which allows a licensee to discontinue royalty payments while successfully "challenging" patent validity.²⁰⁰

ANALYSIS

In *Span-Deck*²⁰¹ the Eighth Circuit confronted the question of what action by a licensee is sufficient under *Lear*²⁰² to constitute a challenge to patent validity so as to justify the cessation of royalty payments.²⁰³ In focusing on this question, the court addressed the issue of whether the mere cessation of royalties would constitute such a challenge.²⁰⁴

In *Span-Deck*, the licensees asserted patent invalidity in April 1973, on the basis that the licensor's patents disclosed only obvious improvements and were, therefore, invalid and un infringed.²⁰⁵ Despite the efforts of both licensees, they were unsuccessful in urging the termination of the licensing agreement under which they were bound.²⁰⁶

In determining whether Fabcon's cessation of royalty payments constituted a valid challenge under *Lear*, the Eighth Circuit implied that to allow the licensees' mere nonpayment of royalties to constitute a valid challenge would be an overbroad extension of *Lear*.²⁰⁷ The policy reasons underlying the *Lear* rationale were to encourage licensees to promptly adjudicate a patent's validity.²⁰⁸ If the licensees in *Span-Deck* were simply allowed to cease making royalty payments without providing affirmative notice of their actions to the licensor, and this action alone was deemed to constitute a valid challenge, the underlying public policy of encouraging prompt adjudication of patent validity would be undermined.²⁰⁹

The court noted that Fabcon ceased payment of royalties in February 1973.²¹⁰ The facts indicate that Fabcon allegedly ceased making payments because of its claimed entitlement to a credit under a "preferred licensee" provision.²¹¹ Whether Fabcon's reason for stopping royalty payments in February was to challenge

199. *Id.* at 1245.

200. *Id.*

201. 677 F.2d 1237 (1982).

202. 395 U.S. at 653.

203. 677 F.2d at 1245.

204. *Id.*

205. *Id.* at 1239.

206. *Id.* at 1249.

207. *See id.* at 1246.

208. *Id.*

209. *See id.* at 1245-46.

210. *Id.* at 1239, 1246.

211. *Id.*

the patent's validity had little bearing under the facts of the case since the court found that in April 1973 a claim of patent invalidity had actually been asserted by the licensees.²¹² The court reasoned that the assertion of patent invalidity constituted a valid "challenge" under *Lear*.²¹³ This assertion coupled with the cessation of royalty payments fell within the scope of the *Lear* rationale for purposes of making a proper challenge to patent validity.²¹⁴

The court then analyzed the particular royalty involved in *Span-Deck*.²¹⁵ The court addressed the issue as to whether the "hybrid" nature of this royalty precluded the applicability of *Lear*.²¹⁶ The licensor, Span-Deck, argued that because the licensees contractually bound themselves to pay a hybrid royalty, federal patent law could not preempt state contract law and preclude the enforcement of the contract.²¹⁷ In support of this proposition the licensor asserted that the dispositive case was *Aronson v. Quick Point Pencil Co.*,²¹⁸ which held that federal patent law does not preempt state contract law in enforcing a licensing agreement.²¹⁹

212. *Id.* at 1246.

213. *Id.*

214. *Id.*

215. *Id.* The licensor, Span-Deck, argued that *Lear* was not applicable because in the present action, the franchise licensing contract was supported by consideration other than the use of the patented invention. *Id.* Span-Deck argued that the non-patent consideration included the use of trade secrets relating to the production of concrete. *Id.* for this reason, it asserted that the royalty was of a hybrid nature. *Id.* See Brief for Appellee at 16, *Span-Deck, Inc. v. Fab-Con, Inc.*, 677 F.2d 1237 (8th Cir. 1982).

216. 677 F.2d at 1247.

217. *Id.* at 1246.

218. 440 U.S. 257 (1979).

219. *Id.* at 266. In *Aronson*, the petitioner filed a patent application to protect a design for a unique type of keyholder. *Id.* at 259. During the pendency of the patent application, the patentee negotiated a licensing contract with Quick Point who agreed to pay a 5% royalty on the sales made from manufacturing an article embodying the licensor's idea. *Id.* The licensing contract provided that if the design was not patented in five years, the royalty would be reduced to 2.5%. *Id.* When the licensor's patent application was rejected, the licensee brought an action for a declaratory judgment that the agreement was unenforceable on the grounds that federal patent law preempted state contract law. *Id.* at 260. The Supreme Court flatly rejected this claim, stating that there was no precedent that justified relieving the licensee of its contractual obligations to pay further royalties. *Id.* at 264. The Court concluded that the exclusive patent monopoly was not used in *Aronson* as leverage to reduce the amount of royalties since the payment of reduced royalties was conditioned on no patent issuing within five years. *Id.* It also concluded that the licensing agreement did not come within the rationale of *Lear*. *Id.* *Lear* encouraged the prompt litigation of patent validity as a means of furthering the federal policy of protecting patented inventions from entering the public domain. In *Aronson*, however, a valid patent was never granted, and consequently, there was no reason to prevent the public from using those ideas. *Id.*

The Eighth Circuit, however, rejected *Aronson* and determined on the facts of *Span-Deck* that federal patent law supplanted state contract law.²²⁰ This holding was based largely on a factual comparison between the two cases.²²¹ In *Aronson*, a patent was never issued and therefore the licensee was prevented from bringing a declaratory judgment seeking an adjudication that the patent was invalid.²²² Consequently, the licensee's only basis for alleging the unenforceability of the royalty agreement was state contract law. In contrast, patents were issued in both *Span-Deck* and *Lear*, enabling licensees in both cases to bring an action under the Declaratory Judgment Act²²³ and thus to challenge patent validity. Therefore, allowing the licensees in *Span-Deck* to bring a patent validity challenge was consistent with *Lear's* public policy concern of encouraging the prompt adjudication of patent validity. Thus, the licensor's argument in *Span-Deck* that the Court's decision in *Aronson* was controlling appears to have been properly rejected by the Eighth Circuit.

Unlike the royalty agreement in *Aronson*, which contained a clause de-escalating the amount of royalties by half in the event a valid patent never issued, the terms of the *Span-Deck* licensing agreement²²⁴ specifically allowed the licensee to avoid all royalty payments if the patents were held invalid.²²⁵ Although it can be argued that state contract law should be applied to enforce a licensing agreement where a licensee is granted an exclusive right

220. 677 F.2d at 1247.

221. *Id.*

222. *Id.*

223. See 28 U.S.C. § 2201 (Supp. V 1981).

224. Paragraph 4.1 of the licensing agreement provides:

In the franchise area, LICENSEE will cooperate with LICENSOR at the sole cost and expense of LICENSOR in taking such legal action as might be reasonably necessary to protect said trademarks, LICENSOR's processes, and the patents thereon. In the event a final judgment should be entered in a Court of competent jurisdiction determining (a) That the right to the use of the name SPAN-DECK is not exclusively vested in LICENSOR and its LICENSEE, for the manufacture of such product in the territory covered by this agreement, or (b) That LICENSOR'S machine and/or processes are not protected by LICENSOR'S patents, with the effect that persons not licensed by LICENSOR may utilize same without liability for infringement, or with the effect that use of same is deemed an infringement of patents owned by persons other than LICENSOR, then LICENSEE may, at its option, terminate this license agreement by giving 60 days notice by registered mail, whereupon *both parties will be released from all obligations under this agreement* except that LICENSEE shall not be released from its Agreement to pay royalties already due or any other accrued obligation, nor from any other agreement herein contained which is stated to be binding subsequent to termination of this contract.

677 F.2d at 1247 (emphasis added).

225. *Id.*

to use an invention, as was the case in *Aronson*,²²⁶ a similar argument may not successfully be applied to the facts of *Span-Deck* because the licensees agreed to pay a hybrid royalty as consideration for the use of *patented* ideas and the knowledge of trade secrets.

In *Aronson*, the patent rights granted by the licensor in exchange for the licensee's promise to pay royalties were found not to have been used as leverage in negotiating the clause reducing the amount of royalties because reduced royalties would only be paid if a valid patent did not issue in five years.²²⁷ In *Span-Deck*, however, it is clear that the patent rights issued to the licensees were used as leverage in negotiating the amount of royalties since the licensees had the option of terminating the agreement and thereby avoiding all royalties for which they were contractually bound if the patents were subsequently declared invalid.²²⁸

Had the Eighth Circuit held that a licensing agreement was enforceable under state law where patent rights were exchanged for the licensee's promise to pay hybrid royalties, the licensor would effectively have been able to undermine the *Lear* public policy consideration of promoting an early adjudication of patent validity.²²⁹ If the agreement were held enforceable under state contract law principles, such a judicial determination would "muzzle" licensees from engaging in litigation challenging the patent validity of an inventor's discovery, a result directly contrary to that intended by *Lear*.²³⁰

CONCLUSION

In *Span-Deck*, the Eighth Circuit confronted the issue of what action by a licensee under *Lear* constitutes a sufficient challenge to patent validity so as to justify the cessation of royalty payments. The court addressed the unresolved issue of whether the mere cessation of royalty payments is a sufficient challenge. In dicta, the Eighth Circuit indicated that it was not. The court's rationale is consistent with that of two other circuit courts which have held that cessation of royalties combined with some affirmative action is required to constitute a "challenge." The decision of the Eighth Circuit clearly falls within the *Lear* rationale of encouraging the prompt adjudication of patent validity. However, since the court

226. 440 U.S. at 262.

227. *Id.* at 265.

228. See note 224 *supra*.

229. 677 F.2d at 1247 n.12.

230. *Id.*

noted that it is at least apparent that the reason for cessation of royalties must be patent invalidity, it appears to leave open the question of whether the mere cessation of royalties constitutes a "challenge" under *Lear* so as to terminate a licensee's liability for royalties, if that cessation is motivated by a clear intent to challenge the patent's validity.

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