Winter 1993

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No-Challenge Termination Clauses:
Incorporating Innovation Policy
and Risk Allocation into Patent Licensing Law

CHRISTIAN CHADD TAYLOR*

[A]lmost any contract problem can be solved as a tort problem by asking what sanction is necessary to prevent the performing or paying party from engaging in socially wasteful conduct, such as taking advantage of the vulnerability of a party who performs his side of the bargain first.1

We should repair this gap between outmoded theory and market reality.2

INTRODUCTION

In 1986, the Department of Justice supported legislation in the United States Senate that would have allowed patent licensors to include in licenses a provision that would authorize the licensor to terminate the license if the licensee challenged the validity of the patent.3 This "no-challenge termination clause" was later introduced in the House of Representatives.4

Licensors supported the provision, reasoning that existing licensing laws were a disincentive to innovation, for they increased the licensor's risk of litigation by allowing a licensee to challenge the patent's validity without incurring contractual obligations.5 Licensees also supported the provision,

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2. Diamond Scientific Co. v. Ambico, Inc., 848 F.2d 1220, 1228 (Fed. Cir. 1988) (holding that one who assigns the rights to a patent or patent application cannot later contend that what was assigned was invalid) (Newman, J., concurring and commenting on the "theory" of Lear, Inc. v. Adkins, 395 U.S. 653 (1969), the celebrated case which struck down the doctrine of licensee estoppel and thereby threatened the enforceability of no-challenge termination clauses).
3. Senator Strom Thurmond proposed Senate Bill 2525, an amendment to the Clayton Antitrust Act. The bill provided that:

Any patent license agreement may provide for a party or parties to the agreement to terminate the license if the licensee asserts in a judicial action the invalidity of the licensed patent, and, if the licensee has such a right to terminate, the agreement may further provide that the licensee's obligations under the agreement shall continue until a final and unappealable determination of invalidity is reached or until [the license is terminated]. Such agreement shall not be unenforceable as to such provisions on the grounds that such provisions are contrary to the Federal patent law or policy.

This type of provision is hereinafter referred to in this Note as a "no-challenge termination clause." Such a clause should be distinguished from a "no-challenge clause," which is a provision that completely bars the licensee from challenging the validity of the patent.
5. These hearings were never reported, William C. Rooklidge, Licensee Validity Challenges and the Obligation to Pay Accrued Royalties: Lear v. Adkins Revisited (Part II), 69 J. PAT [& TRADEMARK]
arguing that existing laws discouraged licensing and increased royalty payments due to the licensor’s increased risk of litigation. Both groups believed that they were competent to negotiate for no-challenge termination clauses, and should possess the contractual freedom to do so.

The Department of Justice contended that, without giving the licensor some leverage through devices such as no-challenge termination clauses, “potential infringers are encouraged to enter into bad faith negotiations for a license when their clear intention is simply to challenge the validity of the patent.” Nonetheless, the bill died in both houses.

6. See Schlicher, supra note 5.

7. Id.


9. Hearings on H.R. 557 Before the Subcomm. on Monopolies of the Commercial Law Comm. on the Judiciary, 100th Cong., 1st Sess. (1987) [hereinafter Monopolies] (statement of Roger B. Andewelt, Deputy Assistant Att’y Gen., Antitrust Div.), reprinted in 339 PRAC. L. INST., supra note 8, at 471, 477-78. The Department of Justice added that “these incentives distort the negotiating process and discourage the efficient licensing of patents.” Id. at 477.

10. Rooklidge, supra note 5, at 25. This was not the first time Congress considered this type of provision. Numerous bills have been introduced in the past 24 years that would have modified the validity challenge rights of parties to a license agreement. The following provisions were parts of much broader bills, and thus the fact that they died in Congress should not necessarily bear on Congress’ intent towards the enforceability of no-challenge termination clauses.

S. 2930, 93d Cong., 2d Sess. (1974) and H.R. 11868, 93d Cong., 1st Sess. (1973) provided that:

(2) The licensor shall, with respect to such patent or to such claim of such patent, have the option of terminating such arrangement: Provided, however, that if any such arrangement is so terminated with respect to less than all of the patents or claims so licensed, and the arrangement itself does not provide for, or the parties thereto are unable, within such time as the court may determine to be reasonable, to agree upon the consideration to be paid for the license under the remaining patents or claims, the court in which the invalidity is asserted shall determine a reasonable consideration to be paid for the patents or claims not terminated.

S. 2255, 94th Cong., 1st Sess. (1975) provided that:

(a) Any licensee may at any time except after his arbitration with the patent owner and a holding of validity of the patent pursuant to section 294 of this title assert the invalidity of a patent in whole or in part, subject to the provisions of this section.
(b)(1) The licensee may assert the invalidity of the patent, in whole or in part, in any action to which he is a party or by sending a written notice to the patentee pursuant to this paragraph. Such notice shall specify with particularity the grounds for invalidity then known to the licensee, and contain a statement that the licensee believes for such reasons he is not obligated to pay royalty to the patentee under the license, or otherwise perform thereunder.

(2) Upon service of such notice the licensee may—
The legality of no-challenge termination clauses in patent licenses remains uncertain, but the necessity of giving licensors the power to negotiate such clauses is more evident in the 1990s than ever. The United States has entered into global competition with the newly integrated European Economic Community ("EEC") and with the Pacific Basin nations. This global competition is largely due to shifts in technology and process innovation.

(A) suspend payment of royalty to the patentee, or any other performance to which the patentee is legally entitled under the license; or
(B) bring a declaratory judgment action (pursuant to title 28, United States Code, chapter 151) against the patentee, to secure a declaration that the patent is invalid; or
(C) both.

(3)(A) The patentee may, within sixty days of his receipt of such written notice, or of the assertion by the licensee of invalidity in litigation, elect to terminate the license. The patentee may not thereafter terminate the license except on grounds other than the action of the licensee taken pursuant to paragraph (1) of this subsection.
(B) If the patentee elects so to terminate, then after the date of termination the licensee shall not be liable to the patentee, under the license, and the licensee shall be liable to the patentee, if at all, only for infringement of the patent, pursuant to this part of the title.

S. 1535, 98th Cong., 1st Sess. § 10 (1983) provided that:
A licensee shall not be estopped from asserting in judicial action the invalidity of any patent to which it is licensed. Any agreement between the parties to a patent license agreement which purports to bar the licensee from asserting the invalidity of any licensed patent shall be unenforceable as to that provision.

... In the event of an assertion of invalidity by the licensee in a judicial action, licensee and licensor shall each have the right to terminate the license at any time after such assertion. Until so terminated by either party, the licensee shall pay and the licensor shall receive the consideration set in the license agreement.


11. Though some commentators believe that such clauses are legitimate, see, e.g., Thomas A. Dieterich, Interface Between Antitrust and Intellectual Property Law, reprinted in 339 PRAC. L. INST., supra note 8, at 9, 49 ("[T]he better rule is that a licensor can terminate a license if a licensee contests validity of a licensed patent. A patent license should provide specifically that licensor can terminate if licensee contests validity. Absent such a provision the licensor may have no right to terminate if the licensee contests validity."); Tipton D. Jennings IV & Carrol L. Bryan II, The Ever Expansive Scope of Lear v. Adkins: Does It Have Limits?, 59 J. PAT. [& TRADEMARK] OFF. SOC'Y 679, 704 (1977) ("[I]t is clear that a licensee cannot be required to terminate or repudiate the license before bringing a declaratory judgment action. Licensors, however, should expressly provide in the license agreement that the license will be terminated upon a non-payment of royalties to leave open the possibility of suing the licensee for infringement ... . . ."). the policies in Lear, discussed infra part I.A, have been adhered to and expanded by most courts such that the enforceability of no-challenge termination clauses is dubious in many jurisdictions. There are no cases, however, specifically addressing the validity of these clauses, probably because most licensing attorneys have had no reason to believe, until the past six years or so, that such a clause could be reconciled with the broad language in Lear. See William C. Rooklidge, Licensee Validity Challenges and the Obligation to Pay Accrued Royalties: Lear v. Adkins Revisited (Part III), 69 J. PAT. [& TRADEMARK] OFF. SOC'Y 63, 89 (1987).


The willingness of the United States to enter into the North American Free Trade Agreement ("NAFTA") and its consideration of expanding free trade to South America is an indicator that global competition is a reality and the United States is trying to maintain leverage. See Stuart Auerbach, U.S., Canada and Mexico Agree to Form Trade Bloc, Pact Would Create World's Largest Commercial Zone, WASH. POST, Aug. 13, 1992, at A1. Forming trade blocs, however, may be more an indicator of the problem than a solution for it.
rather than traditional factors such as wealth, capital availability, and natural resources.\textsuperscript{13}

In order to stay competitive with these developing economic blocs, the United States must innovate more and produce inventions more efficiently.\textsuperscript{14} A new industrial growth policy is essential,\textsuperscript{15} but it must include more than

\textsuperscript{13} THUROW, supra note 12, at 39-51; CHOATE & LINGER supra note 12, at 14-29.

Choate characterizes the role of technology in the global economy as the “Technology Wild Card.” He explains:

Technology is the wild card of the future. At an accelerating pace, it is creating dazzling improvements in goods and services, generating millions of new jobs, revitalizing old industries, and spawning entirely new ones. It is rendering established products and processes obsolete, eliminating millions of existing jobs, and radically transforming millions of others.

Technology is also inducing massive shifts in comparative advantage among industries, firms, and nations, and in the process is giving a powerful competitive edge to those who can apply advances best. Recognizing this unbreakable link between technology and economic competitiveness, industries and nations today are caught up in a desperate race to create, apply, and protect new technologies. If the United States is to maintain competitiveness and jobs, it has no choice but to strengthen its scientific base and improve its capacity to commercialize, deploy, and protect its innovations.

\textsuperscript{14} Id. at 14 (emphasis added).

\textsuperscript{15} Technology Policy and Competitiveness: The Federal Government’s Role: Hearing Before the Subcomm. on Government Information and Regulation of the Senate Comm. on Governmental Affairs, 102d Cong., 2d Sess. 25 (1992) [hereinafter Government’s Role] (testimony of Marc Newkirk, President and CEO, Lanxide); Technology Task Force, House Comm. on Science, Space, and Technology, 100th Cong., 2d Sess. 22 (1990) [hereinafter Task Force]; Report on Technology Policy and its Effect on the National Economy (Comm. Print 1988). Lester Thurow, Dean of Massachusetts Institute of Technology’s Sloan School of Management and a professor of economics, emphasizes the “produce inventions more efficiently” component to innovation. He points out that although the past leaders in economic growth were those countries that could invent new products (the prime examples are the United States and Great Britain during the industrial revolution through World War II), “in the twenty-first century sustainable competitive advantage will come much more out of newprocess technologies and much less out of newproduct technologies. Reverse engineering has become an art form. New products can easily be reproduced.” THUROW, supra note 12, at 45. Thurow points to the fact that although Americans invented the video camera and recorder, and the fax, Japan has dominated the sales of these products because the Japanese are better producers in these areas. Id. at 47. The United States still lags in this area. One current example is the area of Smart Cards. Smart Cards are credit card-like plastic items that contain a built-in microcomputer and memory chip. The potential of such devices is enormous, for one card could act as a personal data base (containing emergency medical information, financial/budgeting information, etc.), a bank account, an access card (to a door, automobile, computer, etc.), and myriad other simultaneous applications. Though many of the patents on such inventions are American, the Europeans lead in development and production. See U.S. DEPARTMENT OF LABOR, APPLICATIONS OF COMPUTER CARD TECHNOLOGY (1989); Yvette DeBow, Credit/Debit Debuts in Midwest Smart Card Test, V6 COMPUTERS IN BANKING 10 (1989); ‘Smart Card’ Adds Brains to Credit Card, L.A. TIMES, May 26, 1992, at D2; William Raspberry, Saving the World With ‘Smart Cards’, WASH. POST, July 7, 1989, at A17.

This growing need to focus on process technology supports one of the themes of this Note, that the law must encourage licensing arrangements while simultaneously making such arrangements more efficient. This is true because licensing is in itself an efficient method of producing and distributing technologies. See discussion, infra part I.B.2.

15. Though the Reagan and Bush administrations refused to form an industrial policy, the Clinton Administration appears likely to form such a policy. See Bush v. Clinton: Can Technology Revive the Economy?, L.A. TIMES, Oct. 18, 1992, at M4 (Opinion Page); see also Katharine Seelye, In Their Own Words, Clinton: What America Needs is Innovation, L.A. TIMES, Apr. 26, 1992, at F1. For the view that the United States does not need an industrial policy, see MICHAEL E. PORTER, THE COMPETITIVE ADVANTAGE OF NATIONS (1990). For a critique of that work, see Dan Morgan, Think Locally, Win Globally, Harvard’s Porter Pushes Regional Clusters as the Key to Industrial Competitiveness, WASH. POST, Apr. 5, 1992, at H1. See also Robert J. Samuelson, Do We Really Need a National Technology Policy? Government Support Isn’t the Answer, WASH. POST, Apr. 1, 1992, at A23.
just increased research and development spending; the legal system must be responsive as well. As one economist explains, "If the United States is to maintain competitiveness and jobs, it has no choice but to strengthen its scientific base and improve its capacity to commercialize, deploy, and protect its innovations." Furthermore, small firms, start-up companies, and individuals, who typically are undercapitalized licensors with fewer resources and less bargaining power than many licensees, are critical to the economy and need legal protection. The law should take into account that these small investors are becoming leaders in our most critical technologies.

Because inventors take risks into account, it is important for them to have the ability to reduce risk by allocating it between both the licensor and the licensee. The EEC allocated this risk by specifically allowing

18. There is strong evidence that small firms are better innovators for two reasons: researchers in these firms usually have more flexibility to take risks, and innovation typically is the best way for these firms to enter into the market and be successful. See J. Jewkes et al., The Sources of Invention 209, 222, 226 (2d ed. 1989); see also F.M. Scherer, Industrial Market Structure and Economic Performance, 416, 428 (2d ed. 1980); Panel Discussion, The Value of Patents and Other Legally Protected Commercial Rights, 53 Antitrust L.J. 535, 537 (1984). Rochelle C. Dreyfus, in Dethroning Lear: Licensee Estoppel and the Incentive to Innovate, 72 VA. L. Rev. 677 (1986), observes that: [T]he "bold, risky departures from known technology"... often have the greatest impact on the quality of life. [A]ny system aimed at stimulating invention should be designed in part to encourage the small research firm. [T]he design of the patent system should be uniquely structured to suit the needs of small, non-integrated firms that can[not] profit from... investment costs during the time before others come into the market. [I]t is especially important to grant them exclusive rights to their inventions for a fixed period of years and to allow them sufficient flexibility in their licensing arrangements to enable them to capture the economic surplus that their inventions generate.

[16] at 728-29; see also Muriel Siebert, Hired Workers Get a Tax Credit, N.Y. Times, Jan. 6, 1983, at A15 (pointing out that small businesses have produced up to 80% of all new jobs in recent years); Peter G. Brown, Initial Conditions, Memorandum to President Bill Clinton, The Sciences, Jan./Feb. 1993, at 2 (arguing that small ventures often create society's most beneficial breakthroughs because "the... glory, precedence, creative thinking and intellectual stimulation make the game worth the candle.").
19. When International Business Machines announced on December 15, 1992, that it would cut 25,000 jobs in 1993 due to record losses, the New York Times ran an article the following day that stated:

[S]ome technology experts say that I.B.M.'s decline may... mark the emergence of a new model for computer and technology development in the United States that will become powerful in its own right. Alliances of smaller, more innovative companies—sometimes working with Government support and sometimes on their own—will come together quickly to attack crucial problems.


20. According to Lester Thurow, most commentators believe that there are seven "key industries" of the next few decades, consisting of microelectronics, biotechnology, new materials industries, civilian aviation, telecommunications, robots plus machine tools, and computer software. Thurow, supra note 12, at 45; see also Government's Role, supra note 14, at 3 (giving recognition to Thurow's "key industry" statements).

22. See generally Rooklidge, supra note 5; Dreyfus, supra note 18.
no-challenge termination clauses.23 Germany favors the licensor even more by allowing no-challenge clauses.24

The Supreme Court case of Lear, Inc. v. Adkins25 and its progeny,26 are the major obstacles to using no-challenge termination clauses in licenses.27 The United States Court of Appeals for the Federal Circuit,28 established in

24. Rooklidge, supra note 11, at 74 (citing F. BEIER ET AL., GERMAN INDUSTRIAL PROPERTY, COPYRIGHT AND ANTITRUST LAWS 176-77 (1983)). The German statute provides that:

Agreements concerning the acquisition or use of patents, utility models, or protected seed varieties shall be ineffective insofar as they impose upon the acquirer or licensee any restrictions on his business conduct which go beyond the scope of the protected right.

. . . . [S]ubsection (1) shall not apply to . . . obligations of the acquirer or licensee not to challenge the protected right.

Id. No-challenge clauses are discussed infra part IIA.


25. Lear, 395 U.S. 653 (1969) (holding that licensees are not judicially estopped from challenging the validity of a patent as a defense to an infringement action).


28. The Federal Circuit only considers cases from the Supreme Court and the United States Court of Customs and Patent Appeals (previously the Court of Customs Appeals) as binding authority. It therefore has the ability to disregard the courts that have broadened Lear to the extent that it endangers the validity of no-challenge termination clauses.

As to the important question of which law a court will follow in deciding the validity of no-challenge termination provisions, the Federal Circuit generally applies the precedents of the appropriate regional circuits in contract-related cases unless it has exclusive appellate jurisdiction. Sun Studs, Inc. v. Applied Theory Assoc., 772 F.2d 1557 (Fed. Cir. 1985) (holding that state law was applicable in determining the enforceability of a patent settlement agreement under the statute of frauds). This general rule suggests that a district court could apply its regional circuit interpretation of Lear.

However, the Federal Circuit later held that it is obligated to set forth its own interpretation of the effect of Lear on consent decree judgments. Foster v. Hallco Mfg. Co., 947 F.2d 469 (Fed. Cir. 1991). The court spoke broadly, stating:
1982 to hear patent cases (among others), however, has taken an approach more amenable to patentees, reversing much of the case law decided in the wake of Lear.\footnote{See generally Foster, 947 F.2d 469 (holding that a consent judgment can preclude validity challenges); Hemstreet v. Spiegel, Inc., 851 F.2d 348 (Fed. Cir. 1988) (indicating that settlement agreements that preclude validity challenges are enforceable); Diamond Scientific Co. v. Ambico, Inc., 848 F.2d 1220 (Fed. Cir. 1988), cert. dismissed, 487 U.S. 1265 (1988); Cordis Corp. v. Medtronic, Inc., 780 F.2d 991 (Fed. Cir. 1985), cert. denied, 476 U.S. 1115 (1986); C.R. Bard, Inc. v. Schwartz, 716 F.2d 874 (Fed. Cir. 1983); infra part III.}

This Note argues that the state of the law under Lear and its progeny effectively eliminated the licensee's risk by shifting it to the licensor,\footnote{See discussion infra notes 131-95 and accompanying text.} and that the Federal Circuit takes an approach more in line with the licensor's needs. Part I of this Note discusses the effect of Lear on the validity of no-challenge termination provisions. Part II reviews the progeny of cases that broadened the Lear holding. Part III discusses several Federal Circuit Court of Appeals decisions which have limited Lear and its progeny, thereby opening the door for the validation of no-challenge termination clauses.

I. Lear and Its Effect on No-Challenge Termination Clauses

No-challenge termination clauses would be legally enforceable if the Supreme Court had not held in Lear, Inc. v. Adkins that licensees cannot be estopped from challenging the validity of their licensed patents. Because the Court did not determine who may not estop the licensees and how they may not be estopped, no-challenge termination clauses could be viewed as falling within the Lear restriction. Such an interpretation of the case, however, would be a misreading of Lear and would place excessive risk on potential licensors.

A. The Case of Lear, Inc. v. Adkins

In Lear, Adkins developed an inexpensive way to improve the accuracy of gyroscopes. At the same time, Lear, Inc. manufactured gyroscopes.\footnote{Adkins v. Lear, Inc., 435 P.2d 321 (1967), vacated, 395 U.S. 653 (1969). Gyroscopes are instruments used in aircraft for direction and altitude information.} In 1954, Adkins applied for patent protection of his improvements and then entered into license negotiations with Lear in 1955.\footnote{Jennings & Bryan, supra note 11.} The resulting license stipulated that Lear could use Adkins' inventions in exchange for royalties on...
net sales of Lear's products. The agreement allowed Lear, the licensee, to terminate the license agreement if Adkins' patent application was unsuccessful or if a court declared the patent invalid. In the meantime, Lear experimented with other methods of achieving gyroscope accuracy, probably taking advantage of the information on Adkins' invention it received through the license negotiations.

Lear began withholding royalties in 1957 after the Patent Office rejected Adkins' application. Lear terminated the agreement in 1959 after a second rejection. Adkins' patent was granted in 1960. He then sued Lear for royalty payments and Lear defended on the basis that the patent was invalid. The California Supreme Court held for Adkins, the licensor, invoking the so-called doctrine of "licensee estoppel." The court defined the doctrine in the following way:

"Under the doctrine of licensee estoppel, Lear would be prohibited from challenging the validity of Adkins' patent if the agreement had not been validly terminated." The California Supreme Court then found that Lear had not terminated the agreement properly under the two termination provisions.

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33. Adkins, 435 P.2d at 324.
34. Id. at 329; see also Jennings & Bryan, supra note 11.
35. Adkins, 435 P.2d at 328.
36. Id.; Jennings & Bryan, supra note 11, at 680.
37. Adkins, 435 P.2d at 330 n.11.
38. Id. at 330. It is not uncommon for patent applications to be rejected before they are finally granted and thus such an occurrence should not necessarily be held against the licensor. As the California Supreme Court explained:

The prosecution of the application before the United States Patent Office will, except in very unusual cases, consist of at least one rejection of some or all of the claims of the application on the ground that a search has indicated they have been anticipated by prior inventions, and the subsequent amendment of the claims or specifications by the inventor. He may then file an amendment which will alter the prior claims, cancel them, or add new claims. This procedure of rejection and amendment is so commonplace that one authority has stated that most patent attorneys view with some misgivings those rare instances in which an application is allowed without amendment because it raises the possibility that the applicant has failed to state his claims as broadly as he could have and that a still broader claim might have been allowed, defining the invention (and thus the protection afforded by the patent) in a manner broader and more advantageous to the applicant.

Id. at 326 (citing ARTHUR H. SEIDEL, WHAT THE GENERAL PRACTITIONER SHOULD KNOW ABOUT PATENT LAW AND PRACTICE 60 (1st ed. 1956)).
39. Id. at 330-31.
40. Id. at 325-26 (citation omitted).
41. Id. at 331.
42. Id. at 325.
The United States Supreme Court reversed, invalidating the doctrine known as licensee estoppel. Justice Harlan, writing for the Court, first cited case law which upheld the doctrine, but concluded that the status of licensee estoppel under these precedents was "uncertain," because "the doctrine [was] so eroded that it could no longer be considered the 'general rule,' but was only to be invoked in an ever-narrowing set of circumstances." The Court noted that it had previously carved out exceptions in the areas of fraud, assignor estoppel, and price-fixing agreements.

The most influential portion of Justice Harlan's opinion included a policy analysis that presently stands as the major obstacle to using no-challenge termination clauses. The opinion stated that two policies were in conflict. First, the law of contracts "forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain." Second, it was necessary to insure the validity of patents, so that unoriginal ideas could remain in the public domain.

In resolving the conflict in favor of federal patent policy, the Court said "the licensor's equities are far from compelling" for a patent only is a "legal conclusion" of the Patent Office, reached without the aid of arguments

45. Lear, 395 U.S. at 668.
46. Id. at 664.
47. Id. at 664-66 (citing Westinghouse Elec. & Mfg. Co. v. Formica Insulation Co., 266 U.S. 342 (1924) (holding that while an assignor may not directly attack the validity of a patent by reference to the prior art, he could introduce such evidence to narrow the patent claims); Scott Paper Co. v. Marcalus Mfg. Co., 326 U.S. 249 (1945) (holding that an assignor could not be estopped when he attempted to show that he simply copied the invention from an expired patent); and Sola Elec. Co. v. Jefferson Elec. Co., 317 U.S. 173 (1942) (holding that a licensee could contest the validity of the patent where the licensor attempted to enforce price-fixing provisions)).

"Assignor estoppel is an equitable doctrine that prevents one who has assigned the rights to a patent or patent application from later contending that what was assigned is a nullity." ROBERT L. HARMON, PATENTS AND THE FEDERAL CIRCUIT 217 (2d ed. 1991). An assignment is an actual transfer of title in a patent, CHOATE, CASES AND MATERIALS ON PATENT LAW 680 (3d ed. 1989), while a license is a contractual agreement between a patentee and one who is granted a right to make, use, or sell under the patent. Id. at 692.

The doctrine of assignor estoppel was struck down in Scott Paper. The Lear Court analogized that the failure of this doctrine indicated that licensee estoppel should likewise be invalidated. Assignor estoppel was resurrected by the United States Court of Appeals for the Federal Circuit in Diamond Scientific Co. v. Ambico, Inc., 848 F.2d 1220 (Fed. Cir. 1988). For analyses of this case, see Amber L. Hatfield, Life After Death of Assignor Estoppel: Per Se Application to Protect Incentives to Innovate, 68 TEX. L. REV. 251 (1989), and infra notes 253-59 and accompanying text.
48. See infra part II.
49. Lear, 395 U.S. at 668.
50. Specifically, the Court said:
On the one hand, the law of contracts forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made. On the other hand, federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent.

Id. (citing Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225 (1964), and Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234 (1964)).
51. Id. at 670.
from parties who may be interested in showing invalidity.\textsuperscript{52} The Court concluded that:

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 uses of ideas which are in reality a part of the public domain. Licensees 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.\textsuperscript{53}

Thus, the Court apparently banned the doctrine of licensee estoppel and in so doing overturned \textit{Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.}\textsuperscript{54}

The Court, however, was not finished. The second half of the opinion indicated that the Court was willing to go to great lengths to protect the licensee,\textsuperscript{55} because it was concerned that federal policies would be "significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging the patent validity in the courts,"\textsuperscript{56} even when the license expressly provides otherwise.\textsuperscript{57}

\textsuperscript{52} \textit{Id.} The Court went on to say:

Consequently, it does not seem to us to be unfair to require a patentee to defend the Patent Office's judgement when his licensee places the question in issue, especially since the licensor's case is buttressed by the presumption of validity which attaches to his patent. Thus, although licensee estoppel may be consistent with the letter of contractual doctrine, we cannot say that it is compelled by the spirit of contract law, which seeks to balance the claims of promisor and promisee in accord with the requirements of good faith.

\textsuperscript{53} \textit{Id.}

\textsuperscript{54} \textit{Automatic Radio}, 339 U.S. 827, 836 (1950) (holding that a licensee could not challenge the validity of the licensed patent) (citing United States v. Harvey Steel Co., 196 U.S. 310 (1905)).

\textsuperscript{55} \textit{Lear}, 395 U.S. at 671-75.

\textsuperscript{56} \textit{Id.} at 673. The Court's analysis was as follows:

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. We can perceive 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. The deterrent effect would be particularly severe in the many scientific fields in which invention is proceeding at a rapid rate. In these areas, a patent may well become obsolete long before its 17-year term has expired. 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 the full and free use of ideas in the public domain. For all these reasons, we hold that Lear must be permitted to avoid the payment of all royalties accruing after Adkins' 1960 patent issued if Lear can prove patent invalidity.

\textsuperscript{57} \textit{Id.} at 673-74.

\textsuperscript{57} The license provisions stated that ""Lear shall have the right on ninety days' prior written notice to Adkins, to terminate any one or more of the licenses herein granted"" and that ""[i]n the event that . . . the U.S. Patent Office refuses to issue a patent on the substantial claims of the application attached as Exhibit 'B', or if such a patent so issued is subsequently held invalid"" then Lear ""shall have the right forthwith to terminate the specific license so affected or to terminate this entire Agreement and no further royalties shall thereupon be payable under the license so terminated or under this Agreement if Lear shall have elected to terminate this Agreement in its entirety."" Adkins v. Lear, Inc., 435 P.2d 321, 329 (1967).
In effect, the Lear case gave the licensee the power to negotiate for a license, sue for invalidity so that he could release himself from royalty obligations, and be free of such payments while the suit was in progress. This power continued to shift from the licensor to the licensee for over a decade through lower court decision-making. These courts took Lear to its extreme, barring virtually every means available for limiting validity challenges by licensees.

B. The Limits to Lear

Two analytical flaws in Lear created confusion in the courts and in the field of licensing regarding licensee estoppel, no-challenge clauses, and no-challenge termination clauses. The opinion misinterprets the history of the doctrine of "licensee estoppel" and omits a major constitutional policy of patent law—encouraging innovation. Resolving these errors reveals that the case's pronounced legal rule and policy analysis must be read narrowly. Such a narrow interpretation of the case supports the validity of no-challenge termination clauses.

1. The Limits to the Lear Holding and the Court's Error in Analyzing the History of "Licensee Estoppel"

The Court's holding in Lear is vague. All that one can be sure of is that it permits a licensee to challenge the validity of the licensed patent under certain circumstances. The Court, however, did not specify these circumstances.

On its facts, the case only invalidated court-imposed estoppel. There was no license provision agreed upon by which a licensee would not be allowed to challenge the patent's validity (no-challenge clause). Nor was there a no-challenge termination clause. Nor was there any discussion concerning interests in contractual freedom other than the Court's recognition that state law exclusively governs contract issues.

The limits of the Lear holding run deeper than just narrowing it to court-imposed estoppel. If the Court had understood the historical meaning of the term it loosely defined as "licensee estoppel," it might not have used such sweeping language. Traditionally, three types of estoppel exist: estoppel by deed, estoppel by record, and equitable estoppel. Estoppel by deed and by record prevent a party to an instrument stating a fact from denying that fact, and by record prevent a party to an instrument stating a fact from denying that fact,
while equitable estoppel (estoppel in pais) prevents a party from contesting
the validity of her conduct that another party relied upon. Equity estoppel
doctrine developed in England in the beginning of the nineteenth century. The
doctrine was based somewhat upon estoppel by deed, but was entirely separate
from equitable estoppel. The doctrine was derived from landlord-tenant
law, which prohibited tenants from challenging the validity of the landlord’s
title as a defense to a suit for rent, based on the fact that the landlord’s title
was not relevant to the withholding of rent payments.

Likewise, the validity of a licensed patent was irrelevant to withholding
royalty payments. In landlord-tenant law, title was irrelevant unless the
tenant was evicted or there was fraud involved. Thus, if a licensee was
“evicted” from its licensing rights or if there was fraud involved on the
licensor’s part, the validity of the patent then became relevant. Furthermore,
the tenant could defend on the basis of invalidity once he terminated
or repudiated the lease. This rule was adopted in the United States by the
middle of the nineteenth century. The American courts mistakenly catego-
rized the rule in terms of estoppel. That error ultimately confused the Lear
majority.

This historical perspective explains the Court’s willingness to accept the
doctrine of “licensee estoppel” in some situations but not others. In Automatic
Radio the licensee did not terminate or repudiate the license agreement and

61. Black’s Law Dictionary 551, 1275 (abridged 6th ed. 1991) defines the terms as follows:
Estoppel by deed. A grantor in a warranty deed who does not have title at the time of the
conveyance but who subsequently acquires title is estopped from denying that he had title at
time of the transfer and such after-acquired title insures to the benefit of the grantee or his
successors.

Estoppel in pais. The doctrine by which a person may be precluded by his act or conduct, or
silence when it is his duty to speak, from asserting a right which he otherwise would have had.

Record, estoppel by. An “estoppel by record” is the preclusion to deny the truth of a matter
set forth in a record, whether judicial or legislative, also to deny the facts adjudicated by a
court of competent jurisdiction.

62. See Rooklidge, supra note 59, at 509.
63. Id.
64. Id. at 509-11.
65. Id.
66. Id. An example of eviction in a patent license is where a patent is held invalid in a suit not
68. Wilder v. Adams, 29 F. Cas. 1216 (C.C.D. Mass. 1846) (No. 17,647), applied the English rule
in deciding that the licensee cannot challenge the validity of the patent when the licensor sues for
accrued royalties.
69. See Rooklidge, supra note 59, at 512.
70. The majority attributed the “uncertain state” of the licensee estoppel doctrine to judicial efforts
“to accommodate the competing demands of the common law of contracts and the federal law of
patents.” Lear, Inc. v. Adkins, 395 U.S. 653, 668 (1969). The Court explained that:

On the one hand, the law of contracts forbids a purchaser to repudiate his promises simply
because he later becomes dissatisfied with the bargain he has made. On the other hand, federal
law requires that all ideas in general circulation be dedicated to the common good unless they
are protected by a valid patent.

Id.
there was no fraud involved, so estoppel applied. On the other hand, the Court, in *Scott Paper Co. v. Marcalus Manufacturing Co.*, did not apply the doctrine because fraud was a factor, just as would have been the case in the parallel landlord-tenant form of validity challenge doctrine. The *Lear* Court, despite its broad language, reached the correct result only because *Lear*, the licensee, terminated the license.

If the majority had correctly analyzed the history of the doctrine of licensee estoppel, a large portion of the Court’s reasoning would likely have been omitted and the true form of the doctrine which properly preserved the balance of power between the licensor and the licensee would have remained legally intact. No-challenge termination clauses would have been enforceable under this scenario. Unfortunately, the *Lear* Court assumed that there was “a chaos of conflicting case law” so it took an all-or-nothing approach, excessively shifting power to the licensee. This shift enabled the licensee to use information concerning the invention to develop its own inventions, sue the inventor, and profit from the invention without paying royalties. The Court compounded this error, however, with an even more fundamental mistake—it forgot to include in its reasoning the most important justification for the existence of American patent law—encouraging innovation.

2. The Neglected Patent Policy

The *Lear* majority excluded from its opinion major constitutional policies that would have made the Court’s dicta more amenable to no-challenge termination clauses. The most important of these is the need for patent law to encourage innovation. The Court, however, now explicitly recognizes these policies. Such recognition supports the case for enforcing no-challenge termination clauses because these clauses encourage people to invent and to license their inventions.

*Lear* advocated the policy of keeping “all ideas in general circulation . . . unless they are protected by a valid patent.” However, the Court neglected two other major patent policies derived from the United States Constitution: encouraging innovation and promoting disclosure of inventions to the

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73. *Id.* In addition, this was an assignor estoppel case. See supra note 47.
75. *Id.* at 668.
76. This is in fact what likely happened in the *Lear* case. See Jennings & Bryan, supra note 11; *supra* text accompanying note 36.
79. U.S. CONST. art. I, § 8, cl. 8 reads: "The Congress shall have 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."
In fact, the Court declared in Dawson Chemical Co. v. Rohm & Haas that "the policy of stimulating invention that underlies the entire patent system runs no less deep" than the policy of free competition.\(^8\)

Innovation policy was not as important to courts prior to and immediately following the Lear decision. America clearly led the world in manufacturing and innovation during the middle part of the twentieth century.\(^8\) Economists argued that Western Europe was economically healthy, but not a threat to American economic power.\(^8\) Japan had the seemingly impossible task of recovering from a lost war and the devastation of two atomic bombs. The United States' economic status seemed not only unmatchable, but also beyond exterior influence.

During the past two decades, though, the international economic environment has changed. The United States lost market share in some of its strongest industries.\(^4\) Information technology linked the world and reduced costs to foreign business.\(^5\) Japan took advantage of new technology and began to catch up with the United States in producing new technologies. By the mid-1980's Japan dominated the global market in personal radios and cassette players, black and white T.V.'s, VCR's, and CD players.\(^6\) The Japanese owned almost a one-third market share of the automobile industry.

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80. See Dawson Chemical, 448 U.S. at 222; Aronson v. Quick Point Pencil Co., 440 U.S. 257, 262 (1979) ("The purposes of the federal patent system [are] [f]irst to foster and reward invention; second, [to] promote disclosure of inventions, to stimulate further innovation and to permit the public to practice the invention once the patent expires; third, . . . to assure that ideas in the public domain remain there for the free use of the public."); Kewanee Oil v. Bicron Corp., 416 U.S. 470, 496-97 (1974) ("The decision of Congress to adopt a patent system was based on the idea that there will be much more innovation if discoveries are disclosed and patented than there will be when everyone works in secret. Society thus fosters a free exchange of technological information at the cost of a limited 17-year monopoly."); Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 230-31 (1964) ("The patent system is one in which uniform federal standards are carefully used to promote invention while at the same time preserving free competition."); see also Rooklidge, supra note 5, at 16. The policy of promoting disclosure of inventions to the public is congruent with encouraging invention; more innovation eventually results in more disclosure after the monopoly term ends. Encouraging disclosure was a policy noted in the celebrated case of Graham v. John Deere Co., 383 U.S. 1, 6 (1966).

Since the Lear case, the Court has explicitly recognized the economic benefits that flow from patents and the agreements to exploit them. Diamond v. Chakrabarty, 447 U.S. 303, 315-16 (1980), vacated, 444 U.S. 1028 (1980).

81. Dawson Chemical, 448 U.S. at 221.
82. THUROW, supra note 12, at 16-17.
83. Id.
84. Government's Role, supra note 14, at 40-49 (statement of Dr. Julie Fox Gorte, Senior Associate, Office of Technology Assessment); id. at 70 (testimony of Erich Bloch, Distinguished Fellow, Council on Competitiveness); Task Force, supra note 14, at 7, 26-27; CHOATE & LINGER, supra note 12, at 3-4. Choate gives several examples, including "advanced computers, semiconductors, aircraft, machine tools, telecommunications, pharmaceuticals, scientific instruments, industrial chemicals, engines, turbines, plastics, steel, automobiles, synthetics, insurance, engineering services, banking, and many others." Id.
85. CHOATE & LINGER, supra note 12, at 15.
86. Id. at 4; see also Task Force, supra note 14, at 26-27, 40.
in 1991. From 1979 to 1989, that country's industrial growth rate was nearly twice that of the United States. In Europe, the twelve states comprising the EEC opened their markets to each other on January 1, 1993. The aggregate GNP of the EEC, led by a unified Germany with a heavily increased labor force, is larger than that of the United States. The dismantling of the U.S.S.R. and the introduction of capitalism in Eastern Europe transformed the EEC into a trading block that is becoming less dependent on the United States militarily and economically, increasing the chances that it will be more bold in protecting its industries.

These developments mean that the United States no longer dominates the markets and will encounter more economic competition through the turn of the century. Virtually all experts agree that innovation is one of the keys, if America is to remain competitive. In light of the U.S. economic domination at the time, the Lear majority probably did not feel compelled to encourage

87. THUROW, supra note 12, at 114.
88. Id. at 72.
89. Although the markets have been opened, the Community still faces numerous obstacles in attaining complete integration.
90. THUROW, supra note 12, at 62.
innovation. 94 Now, however, the once neglected constitutional policy of encouraging innovation is more applicable than ever. 95

C. The Effect of Lear on No-Challenge Termination Clauses

An example of a no-challenge termination clause might be similar to the following provision: "[LICENSOR] retains the right to terminate this agreement if [LICENSEE] asserts in any judicial proceeding or document, during the lifetime of this agreement, that said patents are invalid." 96 The

94. Another explanation for the Lear Court’s neglect of incentives to innovate is that it was greatly concerned with monopolization. See Dreyfus, supra note 18, at 724-25 ("[T]he Lear Court framed the licensee estoppel issue as a choice between two competing goals, research promotion and widespread use ("public access"). Writing in an antipatent, antimonopoly milieu and taking a static view of the interests that favor immediate access to existing innovations, the Court ignored the need to create rules that stimulate future innovation."") (citing Arnold & Goldstein, Life Under Lear, 48 TEX. L. REV. 1235 (1970)).

Donald I. Baker and Richard H. Sayler elaborated on these shifts in patent approach in the Federal Government and federal court system. Baker & Sayler, supra note 8, at 109, 112-34. They divide patent antitrust approaches into two groups: populism and efficiency. Id. at 112. Judge Learned Hand expressed the "populism" approach in the following statement:

[Congress] was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few.

Id. at 112-13 (quoting United States v. Aluminum Co. of Am., 148 F.2d 416, 427 (2d Cir. 1945)). The "economic efficiency" approach focuses on market performance, costs, and economic efficiencies. Id. at 113. The populism approach was more prevalent during the Lear era. Today, the economic efficiency approach dominates the courts and the Federal Government’s line of thought, although the new Clinton Administration’s approach is still uncertain. During the populism era, patents were assumed to be monopolies and thus were under great suspicion. The ex parte nature of the Patent and Trademark Office's patent examinations made the courts even more skeptical. Now, the economic efficiency approach seems to be leaning toward less restrictive views of patent validity. See, e.g., infra notes 249-50 and accompanying text. The Department of Justice summarized this view in 1986:

The courts, including the United States Supreme Court, continue to make statements that reflect a mistaken view that intellectual property protection is antithetical, and really an exception, to principles of competition. These statements fare poorly under close scrutiny.

... I would like to turn to the relationship between patent law and antitrust law. Contrary to popular opinion the two do not conflict.

... Patents, like other regimes of intellectual property, really are not evil monopolies; they simply create property rights. Property rights, in turn, are the cornerstone of an efficient free-market economy. They create the incentive for private investment in productive activity by providing the investor with the means to appropriate the returns from his efforts free from undue interference by third parties.


96. See also HARRY R. MAYERS, DRAFTING PATENT LICENSE AGREEMENTS 119-20 (1984).
preceding analysis of Lear, Inc. v. Adkins\(^\text{97}\) yields five reasons why the case should not bar a no-challenge termination clause today.

First, the Lear Court did not rule on the validity of such a clause. Nor did it rule on no-challenge clauses.\(^\text{98}\) The holding states that a court may not keep a licensee from challenging the validity of a patent through judicially-imposed estoppel. Despite the Court’s sweeping language, it never said that a licensee could not bar himself from challenging a patent’s validity through a contract.\(^\text{99}\) Furthermore, when reconciled with the historically accurate idea of “licensee estoppel,” the case would have at most only invalidated no-challenge termination provisions in certain cases such as fraud and antitrust violations.\(^\text{100}\)

Even if we understand the Court’s decision to mean that a licensee can challenge patent validity in every circumstance, no-challenge termination clauses would not violate such a rule. This type of contractual provision does not bar a licensee from challenging the patent’s validity. It merely gives the licensor the right to terminate the license in such a case, enabling the licensor to sue the licensee for infringement.\(^\text{101}\) If the licensee has a good case for patent invalidity, then he risks little from termination.

Second, the fact that the Court avoided contractual issues lends support to the validity of no-challenge termination clauses. The Court stated:

> Since the California Supreme Court’s construction of the 1955 licensing agreement is solely a matter of state law, the only issue open to us is raised by the court’s reliance upon the doctrine of estoppel to bar Lear from proving that Adkin’s ideas were dedicated to the common welfare by federal law.\(^\text{102}\)

No-challenge termination clauses are contractual in nature—for the consequence of enforcing such a provision is license termination.\(^\text{103}\) Federal courts should avoid interfering with contracts which are reasonable\(^\text{104}\) and

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98. See supra note 59 and accompanying text.
99. See supra notes 31-58 and accompanying text.
100. See supra notes 59-73 and accompanying text.
101. The licensor may not be able to sue licensees for infringement otherwise, since patent licenses guarantee that the patentee’s right of excluding anyone from making, using, or selling the invention does not apply to licensees. Choate, supra note 47.
102. Lear, at 661-62.
103. This is the key difference in analyzing the enforceability of no-challenge clauses and no-challenge termination clauses. No-challenge clauses are somewhat contractual in nature, but the consequence of using such a provision, namely the barring of judicial action, is non-contractual. The patent law casebook of Choate, supra note 47, explains that “[l]icenses are contractual arrangements between a patentee and one who is granted a right to make, use, or sell under the patent. The rules governing license formation, enforcement, and termination are not provided by the patent statutes. They are instead a product of general contract law.” Id. at 686 (emphasis added).
104. In the area of patent antitrust, the Department of Justice under President Ronald Reagan argued that broad antitrust prohibitions should be avoided because they could impede innovation. Instead, it contended that a “rule of reason” approach would be better. Such an approach is used in general antitrust law. It employs a case-by-case analysis to strike down only those practices whose anticompetitive effects outweigh their pro-competitive effects. See 339 PRAC. L. INST., supra note 8, at 642-43. Rooklidge argues that the rule of reason should be used to evaluate no-challenge clauses. See Rooklidge, supra note 5, at 89-90. Such an analysis of no-challenge termination clauses similarly is
competently agreed upon, for many licensees are likely to be experienced in contract law and to know about the risks involved in making such contracts.

Third, no-challenge termination clauses foster constitutional policies. It seems reasonable to believe, as the Lear Court did, that some critical federal policies outweigh contractual freedoms. But in the case of no-challenge termination clauses, contractual freedom buttresses federal policy. In today’s global economy, the United States must innovate more and produce inventions more efficiently. The Supreme Court recently emphasized the importance of this policy. No-challenge termination clauses foster this goal in two ways. No-challenge termination clauses encourage the inventor to appropriate. Clauses that are fraudulent or violate antitrust laws could be struck down, while those provisions that increase innovation and innovative efficiency would be upheld.


105. Dreyfus, in Dethroning Lear, Dreyfus supra note 18, points out that “[b]ecause there are no standards by which to judge whose interest is more weighty, it is more fruitful to focus on the rewards the system offers patentees and to ask whether providing them with a particular reward...is likely to be such an effective stimulant to innovation that its social cost is justified.” Id. at 725 (citing Louis Kaplow, The Patent-Antitrust Intersection: A Reappraisal, 97 HARV. L. REV. 1815, 1821-22 (1984) and Janusz A. Ordover, Economic Foundations and Considerations in Protecting Industrial and Intellectual Property, 53 ANTITRUST L.J. 503, 512 (1984)). This Note contends that the Lear Court failed to include innovation interests on the scales, and that providing licensors with the ability to negotiate no-challenge termination clauses is “an effective stimulant to innovation” in which the “social cost” of allowing a few invalid patents to exist “is justified.”

106. See Task Force, supra note 14; see also United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 344 (D. Mass. 1953), aff’d, 347 U.S. 521 (1954) (discussing the process of innovation as plainly permitted by the antitrust laws as conduct which a competitive society must foster); S. REP. No. 427, 98th Cong., 2d Sess. 23 (1984) (“[T]he international competitiveness of U.S. firms...depends on their ability to remain at the frontiers of technological development.”); Antitrust Division View of 1984: Remarks of J. Paul McGrath, Assistant Attorney General, Antitrust Div., 4 TRADE REG. REP. (CCH) ch. 13,130 (Apr. 15, 1984) (“[I]t is difficult to overstate the importance of technological advance to this country’s economic welfare.”).

One author emphasizes the role that law must take toward economic efficiency in view of history: As throughout history, many resources are closer to common property than exclusively owned. The best that societies have ever accomplished is to raise the private return close enough to the social return to provide sufficient incentives to achieve economic growth. Not only has technological progress been slow throughout most of history, but diminishing returns to the stock of natural resources has been the most critical economic dilemma of mankind. The widespread tendency of states to produce inefficient property rights and hence fail to achieve sustained growth; and the inherent instability of all states...leads to economic change and ultimately to economic decline.

DOUGLASS C. NORTH, STRUCTURAL CHANGE IN ECONOMIC HISTORY 6, 23 (1981).

107. See supra notes 77-81 and accompanying text.

108. Dreyfus presents a different analysis: Inventors were hurt in two ways [because of the Lear case and its progeny]. First, the research community as a whole was forced to bear a new risk. Faced with the difficulty of determining ex ante whether an invention would be innovative enough to merit a patent, yet apparently stripped of the option of state law protection, inventors were forced to discount the expected return from their discoveries by the probability that a patent would (rightly or wrongly) fail to issue or subsequently be invalidated, causing the invention to fall into the public domain before the costs of developing it could be recouped. Second, [it] directly
create. Under such clauses, the inventor/licensor bears less risk of litigation because the licensee risks losing the license if it chooses to challenge the validity of the patent. The licensor, then, has an alternative to filing suit against the licensee for its infringing activities; a task that is likely to be costly and difficult since the licensor may be large, wealthy, and resourceful. Consequently, the licensee is discouraged from using its leverage to enter into bad faith negotiations with the licensor, knowing that it will not necessarily be able to make the invention without paying royalties by leaving the licensor no choice but to sue or abandon its rights.

For the same reasons, the inventor is encouraged to license. Japan and its neighbors are ahead of the United States in some industries partially because they are more efficient at producing inventions. Licensing is a way to use technology more efficiently. It is cheaper for an inventor to give someone with resources the rights to make, use, or sell an invention than to attempt to raise the money herself. A licensee that already has access to capital and equipment can place the product on the market more quickly. In addition, licensees are more willing to enter into licensing agreements because the lower risk of litigation reduces the licensee’s royalty rates.

A fourth reason why Lear should not detrimentally affect no-challenge termination clauses is that empowering the licensor through patent law encourages the licensor to use the patent system. At some point, an inventor must decide whether to protect her invention through state trade secret law or through an expensive patent process. The patent system is usually most desirable to the patentee, especially if the risks of using it are not too high. Public policy holds the patent system superior to trade secret law since, under a patent, the inventor’s monopoly ends after seventeen years, while trade secrets have no term. An additional benefit occurs because use of the patent system promotes the second neglected policy of disclosing inventions to the public.

Ain additional benefit occurs because use of the patent system promotes the second neglected policy of disclosing inventions to the public. No-challenge termination clauses encourage use
of the patent system by giving the potential patentee a way to reduce its risks through efficient licensing agreements.

Finally, while no-challenge termination clauses foster the goals articulated in *Dawson Chemical* of encouraging inventions and disclosure of ideas, what makes the device most attractive is that it does so without unduly impairing the *Lear* policy of ensuring that patents are valid. Licenses may still claim patent invalidity, but they do so at the risk of losing their licenses. If the licensee has a non-frivolous claim, it bears little risk of having to discontinue its use of the invention. Thus, no-challenge termination clauses encourage good faith, legitimate patent invalidity claims while filtering out bad faith negotiations and suits that take advantage of disproportionate resources.

The ability of no-challenge termination clauses to support both innovation and valid patents is aided by the post-*Lear* development of “reexamination.” Since 1985, anyone can request that the Patent and Trademark Office examine

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120. See supra notes 43-54 and accompanying text.

121. For two possible examples of “bad faith” licensing negotiations, see RCA Corp. v. Data General Corp., 887 F.2d 1056, 1063 (Fed. Cir. 1989), and C.R. Bard, Inc. v. Schwartz, 716 F.2d 874, 875 (Fed. Cir. 1983).

122. Decreasing litigation is in itself a legitimate goal of judicial decision-making. The Federal Circuit Court of Appeals recognized this policy in Foster v. Hallo Mfg. Co., 947 F.2d 469 (Fed. Cir. 1991) (holding that a consent judgment can preclude validity challenges) and Hemstreet v. Spiegals, Inc., 851 F.2d 348 (Fed. Cir. 1988) (indicating that settlement agreements which preclude validity challenges are enforceable). Both of these cases incorporated the important policy of res judicata in their analysis.

A symposium in 1989 by the Stanford International Center for Law and Technology and the Stanford Law and Technology Association included discussions of the problem of increased litigation in the important industry of semi-conductors. The emphasis of the talks was on small, start-up companies in the area of semi-conductors. The experts agreed that:

[E]specially since 1980, intellectual property litigation in Silicon Valley has become more frequent and intense, the power balance has shifted against start-ups and the venture capitalists have become more cautious. Although most start-up companies are launched without lawsuits, litigation has become so common that many start-ups today draw up their business plans with built-in litigation contingencies.

... The start-up can ill afford litigation. It needs to devote its money, time and resources to technology development. Furthermore, the threat of an expensive lawsuit may be enough to scare away the start-up's venture capital financing. Patent lawsuits cost from about $500,000 per claim brought to trial, and trade secret suits cost from $300,000 to $500,000. Thus, lawsuits costs can amount to a significant fraction of the venture capitalist's total investment in the start-up, which is typically in the range of $1 to $6 million over a period of several years. Even where no suit is filed, the litigious climate means that a start-up must spend money on preventative measures, such as researching possible patent conflicts and redesigning or licensing its way around any conflicts in its decisions. These preventative measures cut into the venture capitalist's return on investment.

Silverman, supra note 17, at 159-60.

123. See supra text accompanying note 111. See generally Silverman, supra note 17.
the validity of a patent a second time. Such a request can be made anonymously or can be made sua sponte by the Patent and Trademark Office. Furthermore, a court will not bar a reexamination if a licensee requests it in breach of the license. The cost of a reexamination request is significantly cheaper than the cost of litigating a validity suit. This development nullifies the Lear Court’s best reason for outlawing what they thought was licensee estoppel: “[l]icensees may often be the only individuals with enough economic incentive to challenge the patentability of the inventor’s discovery.” The possibility of a cheap, accessible way to challenge patents minimizes the threat that no-challenge termination clauses will hamper the federal goal of valid patents.

Lear should have had little direct effect on the enforceability of no-challenge termination clauses because the holding did not include them and they balance the Court’s concern of encouraging valid patents as well as the constitutional policy of spurring innovation. Yet today such clauses are infrequently used for fear of unenforceability precisely when they would be most useful as the United States faces its greatest economic challenge in fifty years. One of the reasons such clauses are still infrequently used is because many courts chose to expand Lear’s holding.

II. THE LEAR PROGENY AND ITS IMPACT ON NO-CHALLENGE TERMINATION CLAUSES

Many federal courts interpreted Lear very broadly to give licensors even less leverage than they had under Lear. The courts imposed restrictions on licensors in five areas: no-challenge clauses, judicial consent judgments, settlement agreements, royalties in escrow, and licensor powers of license termination in response to royalty withholdings. Though

125. Id. § 1.510(b).
126. Id. § 1.520(b).
128. 37 C.F.R. § 1.20.
130. Rooklidge, considering the effect of reexamination on no-challenge clauses, concludes that “times have changed since Lear, and the relevant attitudes and policies concerning no-challenge clauses have changed with them. Blind extension of Lear to render no-challenge clauses per se unenforceable is indefensible. Rather, that clause should be judged under a rule of reason standard, considering its economic effect.” Rooklidge, supra note 11, at 84. For a discussion of the rule of reason standard, see supra note 104.
132. See infra part II.A.
133. See infra part II.B.
134. See infra part II.B.
135. See infra part II.C.
136. See infra part II.C.
no court has ruled directly on no-challenge termination clauses, the Lear progeny's broadening of Lear has made the enforceability of such provisions dubious.

A. No-Challenge Clauses

Soon after the United States Supreme Court decided Lear, lower courts struck down no-challenge clauses in case after case without exception. Many lower courts invalidated these provisions without analysis. They simply assumed that Lear made the unenforceability of no-challenge clauses obvious.

In Plastic Contact Lens Co. v. W.R.S. Contact Lens Laboratories, Inc., the licensor brought an action against two licensees to recoup royalties under the license agreements. The licensees defended on the ground that the patent was invalid. Though the court found for the plaintiff and thus did not need to rule on the validity of the no-challenge license provision, it did so anyway with no other explanation than that each defendant "violated the no-contest covenant of the respective license agreements, but that covenant does not estop defendants from challenging the patent's validity." The court gave absolutely no consideration to the distinguishable fact that the licensees agreed not to challenge the patent's validity, despite the facts that the parties to the agreement were competent and there was no fraud. This confidence in invalidating no-challenge clauses without analysis would prove indicative of the approach of courts in future rulings on these provisions.

137. No-challenge clauses are license provisions which prevent licensees from challenging the validity of the licensed patent. Such a clause should be distinguished from a no-challenge termination clause. The latter provision is less restrictive, for it merely allows the licensor to terminate a license if the licensee undertakes a validity challenge; no-challenge clauses legally bar such challenges. While many courts have specifically struck down no-challenge clauses, none have dealt with no-challenge termination clauses. The rulings on no-challenge clauses that are provided in this section, however, may affect the legality of no-challenge termination provisions since these decisions demonstrate that the lower courts were willing to ignore contractual freedom in order to expand the Lear reasoning.


140. Id. at 442.
141. Id. at 443.

142. The license provided that "[t]he LICENSEE agrees to refrain from either directly or indirectly attacking the validity of said Letters Patent licensed under this agreement during the term of this agreement." Id. at 442.
143. Id. at 443 (citing Lear, Inc. v. Adkins, 395 U.S. 653 (1969)).
144. The court stated in another part of the opinion that "[e]ach defendant was represented by counsel at the time the license agreement was entered into, and entered into the license agreement freely, voluntarily and with full understanding of the terms thereof, and without any fraud, misrepresentation or duress (physical, economic or otherwise) by plaintiff in the inducement." Id. at 442.
The no-challenge clause question was first before a federal appellate court in *Bendix Corp. v. Balax, Inc.* In *Bendix*, the licensor brought an infringement suit against the licensee, and the licensee claimed that the patent was invalid. Further, the licensee said that the patent was misused because a no-challenge clause was included in the license. The provision purported to prevent the licensee from challenging the patent’s validity beyond the license term. In holding the patent invalid, the Seventh Circuit commented on the no-challenge clause issue. Like the *Plastic Contact Lens* case, the Circuit equated the demise of licensee estoppel in *Lear* with the unenforceability of no-challenge clauses:

> While it is true that a valid patent does afford some "limited protection" ... this is no answer to the thrust of defendants' contention that the licensor may not thereby forever preclude the licensee from challenging the validity of the patent [through use of the no-challenge provision]. [S]ubsequent to the judgment of the district court under consideration here, the Supreme Court in *Lear, Inc. v. Adkins* ... overruled the holding of Automatic Radio Manufacturing Co., Inc. v. Hazeltine Research, Inc.

... From all this we can only conclude that the right to estop licensees from challenging a patent is not part of the "limited protection" [afforded by the patent monopoly].

The court then remanded the issue of whether or not the no-challenge clause constituted patent misuse since *Lear* was not decided until after the trial.

Two years later, the Seventh Circuit again considered the *Bendix* issue in *Panther Pumps & Equipment Co. v. Hydrocraft, Inc.* In that case, patentee Panther Pumps sued Hydrocraft for infringing its patent of a paint spray-gun

145. *Bendix*, 421 F.2d 809 (7th Cir. 1970).
146. *Id.* at 810.
149. *Id.* at 821.
150. *Id.* at 820-21.
151. *Id.* at 821. This case can be limited to its facts. First, the no-challenge clause forever prevented the licensee from challenging the patent's validity. As to this fact the court commented that "[s]uch danger [of unwarranted monopolization] may be even greater here than in the usual licensee-estoppel case for the reason that in the instant case the licensor sought to create an irrevocable estoppel, not one merely extending during the life of the licenses and sales agreements." *Id.* Further, the defendant alleged that through its licensing and sales agreements, the licensor had "blanketed" 75% of the market for the invention. Each agreement contained a no-challenge clause like the one in defendant's license. *Id.* at 820. Notice that these facts could mean the licensor violated antitrust law—the correct result under the pre-*Lear* idea of estoppel. *See supra* part I.B.1 (concluding that the pre-*Lear* case law maintained the proper balance between the risks of the parties to a patent license). Because the claim was misuse, the Seventh Circuit should have limited its analysis to antitrust violations and not implied that no-challenge clauses are per se unenforceable.
Among other contentions, Hydrocraft defended on the theory that the plaintiff misused the patent by including no-challenge clauses in the licenses, though the licensees to these licenses were not parties to the litigation. The Seventh Circuit once again stated that the no-challenge clause was not enforceable—a finding that was completely extraneous to the holding. The court's analysis was, similar to that in *Bendix* and *Plastic Contact Lens*, limited to a mere citation of the *Lear* case: "[i]n *Lear, Inc. v. Adkins* . . . the Supreme Court held that a licensee is not estopped to challenge the validity of a patent; in view of that holding, the 'no contest' provision in the LEMCO license is plainly unenforceable." This time, however, the court refused to rule that the provision constituted patent misuse since the plaintiff did not use the provision to limit competition.

These post-*Lear* decisions concerning the validity of no-challenge clauses affect the validity of no-challenge termination clauses in two ways. First, because the courts assumed in haste that no-challenge clauses were equivalent to judicially-imposed licensee estoppel, without even mentioning counterarguments, they might take the same approach in analyzing the enforceability

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153. *Id.* at 226. Specifically, the patent was on the gun's hydraulic pump, improving the efficiency of the gun's ability to pause operations while spraying was discontinued.

154. For an explanation of the misuse defense, see *supra* note 147.

155. *Panther Pumps*, 468 F.2d at 226. The license in question provided that:

During the life of this Agreement or any extension or continuation thereof, LEMCO agrees not to contest the validity of PANTHER Patent Number 3,254,845 or any continuation divisions or reissues thereof or any corresponding foreign patents, provided however that no royalties shall become payable under this Agreement on subject matter of claims after a finding of invalidity of such claims by any competent court of final Appellate Jurisdiction.

*Id.* at 230-31. This case is distinguishable from *Bendix*. First, the no-challenge clause was limited to the term of the license, unlike the *Bendix* clause. Furthermore, the party claiming the misuse was not the licensee. The court recognized the first distinction, saying, "The case would, of course, present a different issue if either the license provision or the patentee's exploitation of his patent produced economic consequences raising serious questions under the antitrust laws. Such questions were . . . raised in *Bendix Corporation v. Balax*, Inc. . . ." *Id.* at 232.

156. The holding was that, among other things, there was no misuse by the plaintiff. The court said, "We hold that the 'no-contest' clause in the LEMCO license, though unenforceable under *Lear*, does not constitute the kind of 'misuse' of the patent which forecloses recovery of damages from an unlicensed infringer." *Id.* at 232.

157. *Id.* at 231 (emphasis added).

158. *Id.* at 232-33. Other courts subsequently reached the same result. Robintech, Inc. v. Chemidus Wavin, Ltd., 450 F. Supp. 817, 821 (D.D.C. 1978) ("Though no-contest clauses indubitably are unenforceable against the licensee under *Lear, Inc. v. Adkins* . . . such a clause, standing alone, is unlikely to constitute patent misuse . . .") (citing *Panther Pumps & Equip. Co. v. Hydrocraft, Inc.*, 468 F.2d 225, 231-32 (7th Cir. 1972), *cert. denied*, 411 U.S. 965 (1973)); Congoleum Indus., Inc. v. Armstrong Cork Co., 366 F. Supp. 220, 233 (E.D. Pa. 1973) ("While the Court, of course, does not stamp with approval this provision which is plainly unenforceable against a licensee challenging validity, the application of the doctrine of patent misuse to bar enforcement of Congoleum's patents would be too drastic . . . ").

159. For the position that no-challenge clauses should not be per se unenforceable, see Rooklidge, *supra* note 5 at 89-90. Rooklidge believes that no-challenge clauses should be judged by a "rule of reason." For an explanation of the "rule of reason," see *supra* note 104. Rooklidge reviews the economic benefits and detriments of no-challenge clauses. *Rooklidge, supra* note 5 at 84-88. The chief detriment, says Rooklidge, is that consumers are hurt because they pay for the licensee's royalties to the licensor for use of an invalid patent. Notice that this detriment is not as applicable to no-challenge termination clauses since a licensee will be able to challenge and will challenge the validity of the patent if it knows
of no-challenge termination clauses. Both devices are contract oriented, but these courts gave no weight whatsoever to interests in and benefits from contractual freedom, even though these interests were not present in *Lear*.

Second, the courts' refusals to find that no-challenge clauses constitute per se misuse indicates that it is feasible to analyze the enforceability of no-challenge termination clauses in accordance with the pre-*Lear* idea of licensee estoppel. Only when the clause limits competition illegally, as it might have in *Bendix*, should courts not enforce such clauses. This position is enhanced by the fact that no-challenge termination clauses are less restrictive than no-challenge clauses and the fact that no-challenge termination clauses foster critical constitutional policies.\(^{160}\)

**B. Settlement Agreements and Consent Decrees that Prohibit Licensee Validity Challenges**

Two more areas in which many courts expanded the *Lear* holding are no-challenge clauses in settlement agreements and consent decrees.\(^{161}\) The Ninth Circuit struck down a no-challenge clause in a settlement agreement in *Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co.*\(^{162}\) Though the court recognized the policies of settlement and lessening litigation, it said that these interests "must give way to the policy favoring free competition in ideas not meriting patent protection."\(^{163}\)

The Second Circuit agreed with *Golden State* in *Warner-Jenkinson Co. v. Allied Chemical Corp.*\(^{164}\) After Allied counter-claimed against Warner-Jenkinson for infringing Allied's food coloring patent,\(^{165}\) the two parties entered into a settlement agreement that gave Warner-Jenkinson a license in exchange for royalties to Allied. The agreement prevented the licensee from that it is likely to succeed. As Rooklidge explains, the licensee may have enough incentive in reducing its costs to sue for invalidity and enable itself to use the invention for free. No-challenge termination provisions allow a licensee to enjoy the benefit of patent protection until it has the resources to take such action. Simultaneously, such a provision deters bad faith suits by the licensee. See *supra* notes 121-23 and accompanying text. Rooklidge concludes with respect to no-challenge clauses that "[t]he considerations discussed . . . compel the conclusion that no-challenge clauses are not manifestly anti-competitive." Rooklidge, *supra* note 5, at 88 (emphasis in text). He believes that the major problem in analyzing these devices is that the benefits and detriments are difficult to quantify. *Id.* (citing Ordover, *Economic Foundations and Considerations in Protecting Industrial and Intellectual Property*, 53 *ANTITRUST L.J.* 503, 504 (1984)); see also Turner, *Basic Principles in Formulating Antitrust and Misuse Constraints on the Exploitation of Intellectual Property Rights*, 53 *ANTITRUST L.J.* 485, 488 (1984). These conclusions are similarly applicable to no-challenge termination clause analysis.

\(^{160}\) See *supra* notes 104-14 and accompanying text.

\(^{161}\) The *Lear* progeny's attack on settlement agreements and consent decrees is important because these are areas in which the Federal Circuit Court of Appeals has flatly disagreed with the *Lear* line of case law. See *infra* notes 212-29 and accompanying text.


\(^{163}\) *Golden State*, 444 F.2d at 427.


\(^{165}\) *Id.* at 185.
terminating the license for a two year period.\textsuperscript{166} The court found that this provision was unenforceable under \textit{Lear} even though it was part of a settlement agreement, reasoning that the licensee should be able to terminate the license if it successfully challenges the patent's validity.\textsuperscript{167}

Some courts held that consent decrees\textsuperscript{168} were contrary to \textit{Lear}. In \textit{Business Forms Finishing Service, Inc. v. Carson},\textsuperscript{169} the Seventh Circuit held that a consent decree which provided that the plaintiff's patent was valid but not infringed was unenforceable,\textsuperscript{170} even though the defendants did not contend that it was unenforceable.\textsuperscript{171} The court cited \textit{Lear, Inc. v. Adkins} and emphasized that "patent licensees 'may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery.'"\textsuperscript{172}

The nonenforcement of settlement agreements and consent decrees indicates that some courts were willing to expand \textit{Lear} to its outer limits. As in the case of no-challenge clauses, these courts did not spend much effort considering counter-policies. Instead, they concluded that the unenforceability of these devices was a simple extension of \textit{Lear}. As this Note discusses, however, the Federal Circuit’s treatment of consent decrees and settlement

\textsuperscript{166}Id. at 186.
\textsuperscript{167}Id. at 188. The Second Circuit reasoned that:

\begin{quote}
[T]he 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. . . . [W]e are not persuaded by appellee's argument that enforcement of a royalties agreement should prevail where that agreement was part of a litigation settlement. . . . If encouragement of [patent validity challenges] is important enough to justify allowing licensees to sue to invalidate patents, then it makes little sense for us to strain to preserve the termination of such litigation through a settlement. . . . [T]he Lear decision militates against reading such provisions into a settlement agreement.
\end{quote}

\textit{Id.}

\textsuperscript{168}A consent decree is defined as a judgment to which the litigating parties agree. Such a device differs from a settlement agreement in that the latter may decide issues without prejudice, while a consent decree necessarily incorporates the idea of res judicata. BLACK'S LAW DICTIONARY 410, 1372 (6th ed. 1990).


\textsuperscript{170}Business Forms, 452 F.2d at 75.
\textsuperscript{171}Id. at 70.
\textsuperscript{172}Id. at 74 (quoting Lear, 395 U.S. at 670 (1969)).
agreements indicates that the Lear progeny's assumptions are subject to attack.\footnote{173}

C. Escrow Accounts and the Licensor's Ability to Terminate the License When Licensees Stop Paying Royalties

Possibly the case law most threatening to no-challenge termination clauses came in the form of preventing licensors from terminating licenses in response to licensees filing validity suits and ceasing royalty payments.\footnote{174} When courts allowed licensees to maintain the license during suit by placing royalty payments in escrow to be later recouped by the licensee should the licensee's suit succeed, they created another limit to the licensor's leverage.

\textit{Crane Co. v. Aeroquip Corp.}\footnote{175} became one of the most often cited cases in this area. In \textit{Crane}, a settlement agreement included a license that covered a patent on an air-conditioning system mechanism. The license agreement stated that:

\begin{quote}
[s]hould AEROQUIP fail to make payments as provided in Sections 3 and 4, CRANE shall have the right to terminate the exclusive license . . . and to elect a nonexclusive license grant . . . . In the event of termination of the exclusive license under this Agreement by CRANE, AEROQUIP shall not be relieved of its obligation for the payments . . . .\footnote{176}
\end{quote}

About a year into the agreement and without notice to licensor Crane, the licensee Aeroquip started manufacturing and selling "modified" versions of these mechanisms.\footnote{177} These "modified" mechanisms were marked with the patent number of the licensed patent mechanism. Aeroquip refused to pay royalties on the "modified" mechanisms and thereafter licensor Crane filed suit for breach to recover the royalties.\footnote{178} Aeroquip defended on the grounds that the "modified" mechanisms did not infringe the patent and that the patent was invalid.\footnote{179} Licensor Crane then terminated the agreement, justifying its

\begin{footnotes}
\item[173] See \textit{infra} notes 212-29 and accompanying text.
\item[174] These cases allowed a licensee "to have its cake and eat it too," for a licensee had little to lose from suing for patent invalidity: if it won, it could continue using the invention without paying royalties; if it lost, it still had a contract with the licensor that enabled the licensee to profit from the invention. Because licenses may be non-exclusive, a licensee with an advantage in wealth would almost always have an interest in bringing suit under this case law, unless the licensee knows that there is no likelihood of success. If the licensee is operating under a non-exclusive license, it is likely that it has competition already, so that destroying the patent monopoly will have little negative economic effect. In fact, the economic effect of a winning validity suit by the licensee would be highly beneficial to it in the short run. The manufacturing process may be so expensive that entry by potential competitors is unlikely. Furthermore, even if the market is relatively easy to enter, the licensee still has the experience and the resources in place to make, use, or sell the product more efficiently than others just entering the market. Finally, the licensee's position is further enhanced since it no longer needs to pay royalties, increasing its wealth and productive capability.
\item[175] \textit{Crane}, 356 F. Supp. 733 (N.D. Ill. 1973), \textit{modified on other grounds}, 504 F.2d 1086 (7th Cir. 1974).
\item[176] \textit{Id.} at 735-36.
\item[177] \textit{Id.} at 735, 737.
\item[178] \textit{Id.} at 736.
\item[179] \textit{Id.}
\end{footnotes}
actions on the grounds that Aeroquip had breached the royalty provision and that Aeroquip's assertion of the patent's invalidity was effectively a repudiation of the license.\textsuperscript{180}

The Northern District of Illinois interpreted both of Crane's arguments as "essentially" an attempt to justify license termination "because the licensee has raised the validity defense."\textsuperscript{181} The court reasoned that absent \textit{Lear}, Crane's contentions constituted grounds for termination of the license.\textsuperscript{182} The court concluded, however, that:

\[\text{T}he\ policy\ considerations\ found\ to\ be\ determinative\ in\ the\ \textit{Lear}\ case\ should\ have\ equal\ force\ here.\ldots\text{Although\ the\ facts\ and\ issues\ in\ \textit{Lear}\ required\ the\ court\ to\ go\ no\ further\ than\ to\ hold\ that\ the\ doctrine\ of\ licensee\ estoppel\ would\ no\ longer\ be\ a\ defense\ available\ to\ licensors\ and\ that\ a\ licensee\ would\ be\ able\ to\ challenge\ the\ validity\ of\ the\ patent\ without\ having\ to\ continue\ paying\ royalties\ldots\text{the\ rationale\ of\ \textit{Lear}\ must\ surely\ extend\ to\ the\ converse\ situation\ raised\ in\ this\ case.\ldots\text{[J]ust\ as\ the\ imposition\ of\ the\ doctrine\ of\ licensee\ estoppel\ would\ have\ a\ chilling\ effect\ on\ meritorious\ challenges\ to\ patents\ldots\text{so\ would\ the\ threat\ of\ termination\ of\ the\ license\ have\ a\ similar\ effect.\ If\ raising\ the\ defense\ of\ validity\ were\ sufficient\ grounds\ for\ terminating\ a\ license,\ then\ licensees\ might\ hesitate\ to\ challenge\ a\ patent\ because\ of\ the\ potential\ sanction\ in\ doing\ so.}}\textsuperscript{183}\]

The court rejected the argument that barring termination of the license would effectively allow Aeroquip to maintain a monopoly on the "modified" parts and simultaneously prevent Crane from benefiting from its invention.\textsuperscript{184} The court's response to this contention was that the policy of promoting valid patents through validity suits outweighs such detriments to the licensor.\textsuperscript{185} 

\textit{Crane} took \textit{Lear} to the extreme. No longer was the judiciary protecting a licensee's \textit{capacity} to challenge validity as it did in \textit{Lear} and in the areas of no-challenge clauses, settlement agreements, and consent decrees. Instead, the court articulated a willingness to eliminate any devices that may "threat\textsuperscript{en}" or "chill" the licensee's \textit{eagerness} to challenge the validity of the patent. This approach detrimentally affects the incentive to innovate and license. \textit{Crane} not
only encourages a licensee to enter into bad faith negotiations for a license in order to eventually make, use, or sell the product without paying royalties, but it creates a situation where it would be foolish for the licensee not to "modify" the product, wait for the licensor to sue for royalties, and attempt to draw out the litigation. During litigation, the licensee profits from the product without paying royalties or incurring competition from other licensees. The licensor, on the other hand, must incur litigation without collecting royalties and, if the licensee holds an exclusive license, without the right to license the patent to another. No-challenge termination clauses would help avoid this result by allowing licensors to free themselves from agreements so that they could sue for infringement and benefit from their patents by entering into other licenses.

The Second, Sixth, Seventh, and Ninth Circuits expanded the licensee's power even more than Crane and Lear with respect to royalties. In Lear, although the court released the licensee from royalty obligations of the license during suit, the licensee had repudiated the license by refusing to pay royalties. In Crane, the licensee also continued the license obligations under the patent by claiming that the "modified" mechanisms did not fall under the license. The appellate court decisions, however, would go so far as to allow licensees to avoid royalty payments during suit without repudiating the license by putting the royalties in escrow.

The Sixth Circuit reached this result in Atlas Chemical Industries, Inc. v. Moraine Products, by reasoning that escrow royalties "is a commendable procedure to preserve the status quo during the course of litigation" and would be a "strong inducement [for the licensee]. . . to challenge the patent." The Ninth Circuit endorsed this analysis in St. Regis Paper Co. v. Royal Industries The Seventh Circuit acknowledged the widespread

186. See supra note 9 and accompanying text.
187. Another district court reached the same result with respect to a patent that was not "modified." In Lee v. Lee Custom Eng'g Inc., 476 F. Supp. 361 (E.D. Wis. 1979), the court found that the "speed and efficiency" gained by allowing licensees to withhold royalties while challenging the validity of patents would be lost if licensees could terminate licenses, even though it "may seem unfair to allow the licensee to continue receiving benefits under the license agreement while depriving the licensor of royalties." Id. at 363-64 (citing Crane Co. v. Aeroquip Corp., 356 F. Supp. 733 (N.D. Ill. 1973), modified on other grounds, 504 F.2d 1086 (7th Cir. 1974)). Contra Nebraska Eng'g Corp. v. Shivvers, 557 F.2d 1257 (8th Cir. 1977); Telectronics Pty. Ltd. v. Cordis Corp., 533 F. Supp. 453 (D. Minn. 1982); Morton-Norwich Prods., Inc., v. International Salt Co., 183 U.S.P.Q. (BNA) 748, 750-51 (N.D. N.Y. 1974); In re Certain Fluidized Supporting Apparatus, 225 U.S.P.Q. (BNA) 1211, 1216 (Ct. Int'l Trade 1984).
188. See supra notes 55-58 and accompanying text.
190. The Sixth Circuit seemed to be on the opposite course in two earlier cases. The court first held that a licensee could not recoup all royalties nor royalties during appeal where it was successful in challenging the patent's validity. Troxel Mfg. Co. v. Schwinn Bicycle Co., 465 F.2d 1253 (6th Cir. 1972) (Troxel I). The court later ruled that the licensee must pay royalties accruing prior to the final invalidity decision. Troxel Mfg. Co. v. Schwinn Bicycle Co., 489 F.2d 968 (6th Cir. 1973), cert. denied, 416 U.S. 939 (1974) (Troxel II).
192. Id. at 6-7 (citing Troxel I, 465 F.2d at 1257).
acceptance of this position and adopted it in *Precision Shooting Equipment Co. v. Allen*\(^{194}\) as did the Second Circuit in *Warner-Jenkinson Co. v. Allied Chemical Corp.*\(^{195}\)

As these courts continued to destroy any potential impediments to a validity suit by a licensee, the likelihood of a no-challenge termination clause withstanding judicial scrutiny decreased. *Lear* and its progeny would allow licensees to sue licensors for patent invalidity without paying royalties while simultaneously holding the licensor to its obligations under the license. Under this scenario licensees took little if any risk in bringing suit. Unfortunately, licensors bear great risk in entering into licensing agreements in the first place, for the *Lear* progeny drastically increased the chances that licensors would be forced to pay for expensive and possibly lengthy litigation while not receiving any benefit from the licensed patent. Because the progeny also struck down no-challenge clauses in licenses, settlement agreements, and consent decrees, the licensor had no leverage against the licensee. If the courts were willing to favor licensees this much, it is no wonder that many attorneys assumed that no-challenge termination clauses were probably unenforceable. However, the tide changed in the early 1980's with the creation of the Court of Appeals for the Federal Circuit.

**III. THE ENFORCEABILITY OF NO-CHALLENGE TERMINATION CLAUSES UNDER THE COURT OF APPEALS FOR THE FEDERAL CIRCUIT**\(^{196}\)

The Federal Courts Improvement Act of 1982 established the Federal Circuit Court of Appeals.\(^{197}\) In order to make patent law more uniform and to alleviate the regional circuits’ burden of dealing with specialized technical matters,\(^{198}\) Congress gave the Federal Circuit jurisdiction over all patent appeals from the district courts and from the Patent and Trademark Office.\(^{199}\)

During many of the same years that the Reagan Justice Department took a strong stance in favor of patentees,\(^{200}\) the Federal Circuit likewise favored patentees more than the regional circuits did and proceeded to shift modern

\(^{194}\) *Precision Shooting*, 646 F.2d 313, 321 (7th Cir. 1980), cert. denied, 454 U.S. 964 (1981) ("Under the challenge approach adopted by the district court, all the post-challenge royalties are safely in escrow for whomever may be found to be entitled to them. It appears delay in the resolution of the controversy favors neither party. Nor is either party made to assume risks not necessary to the resolution of validity. We adopt that approach. It is not a new one.").

\(^{195}\) *Warner-Jenkinson*, 567 F.2d 184, 188 (2d Cir. 1977).

\(^{196}\) For a discussion of whether a district court would be bound to use the Federal Circuit’s interpretation of *Lear* in ruling on the enforceability of no-challenge clauses, see supra note 28.


\(^{200}\) See supra notes 3-9 and accompanying text.
patent law significantly in favor of inventors. The court repeatedly emphasized the policy of stimulating innovation through patent protection. Consequently, the Federal Circuit has heightened the burden on infringers who attempt to challenge the validity of the patent as a defense. While the Lear Court viewed a patent as a mere "legal conclusion" by the Patent and Trademark Office, the Circuit takes the view that "[a] patent is born valid.

Furthermore, the Circuit took a more lenient approach towards patent-antitrust issues. Unlike Lear and its progeny of case law, the Federal Circuit does not scrutinize patents suspiciously, but instead emphasizes that patent law and antitrust law are complementary because they both are designed to promote competition.

Together, these two policy shifts—antitrust relaxation and heightened presumptions of patent validity—reached into the scope of licensee validity


202. Atlantic ThermoPlastics Co., Inc. v. Faytex Corp., 974 F.2d 1279, 1284 (Fed. Cir. 1992) (stating that patent law is intended to foster licensing and innovation); Amgen, Inc. v. United States Int'l Trade Comm'n, 902 F.2d 1532, 1539 (Fed. Cir. 1990) ("A continuing goal of Congress is to encourage innovation by providing meaningful protection for the inventions and discoveries of American inventors and for the manufacture of innovative products made by American workers."); The Federal Circuit has also ruled that the introduction of new evidence requires the plaintiff to introduce clear and convincing evidence. Panduit Corp. v. Dennison Mfg. Co., 810 F.2d 1561, 1574 n.28 (Fed. Cir. 1987) (stating that the one purpose of the establishment of the Federal Circuit was "to foster technological growth and industrial innovation"); Panduit Corp. v. Dennison Mfg. Co., 810 F.2d 1561, 1574 n.28 (Fed. Cir. 1987) ("The patent system, which is rooted in the Constitution . . . serves a very positive function in our system of competition, i.e., 'the encouragement of investment based risk'. . . . By so doing, it 'encourages innovation and its fruits: new jobs and new industries, new consumer goods and trade benefits . . .'.") (citing Loctite Corp. v. Ultraseal Ltd., 781 F.2d 861, 876 (Fed. Cir. 1985); Paulik v. Rizkalla, 760 F.2d 1270, 1276 (Fed. Cir. 1985) (en banc); and Patlex Corp. v. Mossinghoff, 758 F.2d 594, 599, modified on other grounds, 771 F.2d 480 (Fed. Cir. 1985)); In re Wiggins, 488 F.2d 538, 543 (C.C.P.A. 1973) ("[T]he purpose sought to be effectuated by the patent law is the encouragement of innovation."). The Court of Customs and Patent Appeals decisions are binding authority for the Federal Circuit.


206. Loctite, 781 F.2d at 876.
challenges and royalty obligations. Though the Federal Circuit often affirmed the narrow holding of *Lear*, it refused to extend the holding as the *Lear* line of case law eagerly did.\(^{207}\) In fact, the court reversed these rulings in the areas of settlement agreements,\(^{208}\) consent decrees,\(^{209}\) escrow payments,\(^{210}\) and licensor termination powers in response to a licensee's cessation of royalty payments.\(^{211}\) The Federal Circuit did not rule on the validity of no-challenge clauses, but through its departure from the aforementioned *Lear* progeny doctrines the court implicitly indicated that no-challenge termination clauses are enforceable.

A. The Federal Circuit's View of Settlement Agreements and Consent Decrees that Prohibit Licensee Validity Challenges

The Federal Circuit directly reversed the *Lear* progeny of case law with respect to settlement agreements and consent decrees that prohibit licensee validity challenges. Though many circuits perceived the *Lear* policy of allowing licensees to challenge validity as restrictionless, the Federal Circuit indicated that this policy was indeed vulnerable to countervailing interests.

In *Hemstreet v. Spiegel, Inc.*,\(^{212}\) after a week of trial proceedings, the parties entered into a settlement agreement which stated that "the issues of validity, enforceability and infringement . . . are hereby finally concluded and disposed of."\(^{213}\) The agreement further provided that the licensee had to continue paying royalties "notwithstanding that said patents-in-suit may be held invalid and/or unenforceable in any other proceeding at a later date[.]."\(^{214}\) The licensee later brought suit, claiming that the patent was invalid because a district court had earlier found that the patentee had committed inequitable conduct before the Patent and Trademark Office in the application process, making the patent unenforceable.\(^{215}\) The licensee asked the court to deem the license provision unenforceable under *Lear*.

The Federal Circuit pointed to the strong policy of settlement,\(^{216}\) and hinted that the licensee's inability to use the district court's decree of the patent's unenforceability was the licensee's own fault, for it "committed itself to make payments even if [the patent was held unenforceable]. Now that the event has happened, [the licensee] seeks to escape commitment. It cannot do so."\(^{217}\) The court refused to sympathize with the licensee even though the

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208. See infra notes 212-20 and accompanying text.
209. See infra notes 221-29 and accompanying text.
210. See infra notes 244-50 and accompanying text.
211. See infra notes 230-43 and accompanying text.
213. Id. at 349.
214. Id. at 350.
217. Id. at 350.
judgment that made the patent unenforceable occurred ten years after the execution of the settlement agreement. To hold otherwise "would seriously decrease the willingness of parties to settle litigation on mutually agreeable terms." The Federal Circuit proceeded to find that the Lear policy of encouraging valid patents "occup[yed] a subsidiary position" to settlement interests. Hemstreet indicates that the Federal Circuit is capable of going to great lengths in order to protect a patentee, for the court allowed the oxymoronic result of permitting a licensor to benefit from a patent which had judicially been deemed unenforceable in a proceeding brought by a party other than the licensee.

Three years later, the Federal Circuit again circumvented the Lear policy, but this time in the context of consent decrees. In Foster v. Halco Mfg. Co., the licensee, Foster, and the licensor, Halco, entered into a consent judgment which provided that the patents "owned by [Halco] . . . are valid and enforceable in all respects." Four years following this decree, Halco demanded that Foster pay royalties for what Foster called "new" and non-infringing versions of the patent which Foster had begun making and selling. Foster instead sued Halco, claiming that Halco's patents were invalid and that the consent decree was unenforceable because it was effectively a no-challenge agreement and thus void under Lear. The magistrate below agreed with Foster, pointing out that a consent judgment often involves minimal judicial scrutiny and little if no evidence, as was the case here.

The Federal Circuit reversed, echoing the Lear analysis it set forth in Hemstreet:

[B]roadly speaking, Lear expresses a policy in favor of precluding restrictions on attacks on patent validity. However, the Court in Lear did not deal with the situation where litigation is terminated by a consent decree which by its terms acknowledges a patent's validity. In such a situation other public policy considerations come into play, namely, preserving the finality of judgments as well as the strong public policy of encouraging settlements.

... [W]e conclude that general principles of res adjudicata apply, despite the policies favoring challenges to validity expressed in Lear.

The language of Foster and Hemstreet favorably affects the enforceability of no-challenge termination clauses in three distinct ways. First, the cases demonstrate that Lear should be limited to its facts, for the Supreme Court

218. Id.
219. Id. (citation omitted).
220. Id. at 351.
221. Foster, 947 F.2d 469 (Fed. Cir. 1991).
222. Id. at 472. The judgment also provide that "[d]efendant R. Keith Foster . . . has infringed claims of [Halco's] patents." Id.
223. Id. at 472-73.
224. Id. at 473.
226. Id. at 474-75.
"did not deal" with consent decrees or settlement agreements. Likewise, the Court did not consider any agreements by which licensees negotiate not to challenge the patent's validity—including no-challenge termination clauses; Lear only invalidated judicially-imposed estoppel.\(^2\) Second, the cases show that the Federal Circuit is not reluctant to balance other policies against the Lear policy favoring validity challenges. Given the fact that the Federal Circuit has often espoused the national interest in innovation and patent law’s inherent purpose in fostering that interest,\(^2\) it seems likely that the Federal Circuit would place such interest on the scales against Lear policies in analyzing the validity of no-challenge termination clauses. Finally, the Federal Circuit gave weight in these cases to contractual freedom, an interest that no-challenge termination clauses support. For instance, in Hemstreet the court implied that the licensee was competent to make the settlement agreement and would have to accept responsibility for its own actions.\(^2\) The Federal Circuit’s benevolence to licensors does not end with consent decrees and settlement agreements, for the Federal Circuit also rejected the Lear progeny’s holdings as to licensee royalty obligations.

**B. The Federal Circuit’s View on Licensee Royalty Obligations and Licensor Termination Powers**

While the cases concerning the licensor’s right to place royalties in escrow during a validity challenge and the licensor’s right to terminate the license for non-payment of royalties may have posed the greatest threat to no-challenge termination clauses in the regional circuits,\(^2\) the Federal Circuit’s treatment of these issues provides the greatest support for the clauses. The Federal Circuit gave licensors new rights in terminating license agreements when licensees sue and refuse to pay royalties.

The Federal Circuit began its rebuke of lower court cases such as Crane Co. v. Aeroquip Corp.\(^2\) and Atlas Chemical Industries, Inc. v. Moraine Products\(^2\) with C.R. Bard, Inc. v. Schwartz.\(^2\) In that case, licensor Schwartz granted Bard an exclusive license to make, use, and sell a catheter assembly in exchange for royalties. The license agreement provided that “[i]n the event BARD asserts invalidity of any of the said Patents within the scope of this Agreement and refuses to pay royalties on account of such asserted invalidity, then GRANTOR may terminate this Agreement as to the Patent or Patents as to which invalidity is asserted.”\(^2\) Bard ceased paying royalties

\(^{227}\) See supra text accompanying notes 98-99.
\(^{228}\) See supra note 202.
\(^{229}\) Hemstreet, 851 F.2d at 350.
\(^{230}\) See supra note 174 and accompanying text.
\(^{231}\) Crane, 356 F. Supp. 733 (N.D. Ill. 1973), modified on other grounds, 504 F.2d 1086 (7th Cir. 1974); see supra notes 175-89 and accompanying text.
\(^{232}\) Atlas, 509 F.2d 1 (6th Cir. 1974); see supra notes 190-95 and accompanying text.
\(^{233}\) Bard, 716 F.2d 874, 875 (Fed. Cir. 1983).
\(^{234}\) Id. at 881 n.5.
and Schwartz filed suit in state court to retrieve these royalties. In addition, Schwartz alleged that licensee Bard had committed fraud, in that Bard had never intended to make, use, or sell the assembly, but instead entered into the exclusive license purely as a means to limit competition in the catheter market in order to promote its own products. Bard responded by filing a validity suit in federal district court, asking that court to declare the license agreement unenforceable under Lear, and demanding that all royalties it had already paid be returned. Schwartz countered that because neither it nor Bard terminated the agreement, the court should estop Bard from bringing a validity challenge while the license was still in existence.

The Federal Circuit held that because Bard “had a reasonable apprehension of an infringement suit [by Schwartz],” Bard could bring the validity action without terminating the license. In doing so the court reasoned that “always” requiring termination of licenses before licensees could bring validity challenges would be “contrary to the policies expressed in Lear.” Though the court affirmed the importance of the Lear policies, this holding was still more favorable to the licensor than were many of the regional circuit treatments. As discussed earlier in this Note, many regional circuits and district courts would have reached this result in every case. In Bard, however, the Federal Circuit explicitly limited its holding to “the facts of this case ... in the totality of the circumstances,” which were that the licensee had stopped paying royalties, creating a breach of contract which enabled licensor Schwartz to terminate the license “under the very terms of the agreement.”

This breach, the court reasoned, gave the licensor the power to sue for infringement, in turn giving licensee Bard a reasonable apprehension of suit. The finding that the licensee had breached the agreement itself virtually acknowledges the validity of no-challenge termination clauses. By ruling that the provision was enforceable, the Federal Circuit effectively held that license provisions which give licensors the right to terminate licenses are enforceable when licensees bring validity challenges and cease making royalty payments. The only difference between a no-challenge clause and the Bard provision is that in the latter the licensee must also stop paying royalties before a licensor may terminate the license.

235. Id. at 875.
236. Id. Schwartz also charged that Bard failed to use its best efforts, as the contract required, to promote and sell the invention, that it breached its fiduciary obligation under the license by not promoting the invention, and by not disclosing its intentions not to promote it, that it did not report and pay royalties on an embodiment of the invention, and that Bard’s purported sublicense with another company was an assignment under which no royalties were paid. Id. at 875-76.
237. Id. at 879-81.
238. Id. at 880.
239. Id.
240. See supra notes 175-87 and accompanying text.
241. Bard, 716 F.2d at 880.
242. Id. at 881.
243. Id. at 880-81.
The Federal Circuit ventured a step further in *Cordis Corp. v. Medtronic, Inc.* In *Cordis*, the court held that the licensors could terminate the agreement when the licensee ceases making royalty payments, even without a license provision enabling the licensor to do so. Additionally, the *Cordis* court departed from the regional circuits by barring licensees from depositing royalties in escrow during litigation. The Federal Circuit spoke very broadly and made it very clear that *Lear* is limited by policies beyond res judicata principles which were present in consent decrees and settlement agreements:

This [Lear] policy statement does permit a licensee to cease payments due under a contract while challenging the validity of a patent. It does not permit the licensees to avoid facing the consequences that such an action would bring. The holding of Lear only prevents the affirmative enforcement by the licensor of the royalty payment provisions of the license agreement while the patent's validity is being challenged by the licensee.

... [If] the licensees] wish to continue to invoke the protections of their licensing agreements, they should be required to continue paying their royalties to the [licensor]. ... It would not be fair for the plaintiffs to be allowed simultaneously to reap all the benefits of the licensing agreement and to deprive the licensor of all his royalties. Patents are presumed valid. ... Until invalidity is proven, the patentee should ordinarily be permitted to enjoy the fruits of his invention. The principal effect of an escrow arrangement would be to put undeserved pressure on the [licensor].

This language represents a departure from *Lear* and its progeny’s view of licensing arrangements: where the latter viewed patents as mere “legal conclusion[s] ... predicated on factors as to which reasonable men can differ widely,” the Federal Circuit emphasizes that patents are “presumed valid” and must yield benefits to licensors until “proven invalid”; while the *Lear* progeny voided devices that had a “chilling effect” on validity challenges, the *Cordis* court says that *Lear* only prevented affirmative enforcement of royalty payments and that licensees must “face[e] the consequences” of validity suits; and while *Lear* found that “the equities of the licensor do not weigh very heavily,” the Federal Circuit emphasizes “fair[ness]” to licensors.

The Federal Circuit’s attitude favoring licensors who may face validity challenges strengthens the case for enforcing no-challenge termination provisions. If licensors can terminate licenses, even absent license provisions for doing so, when licensees cease paying royalties and bring validity suits so that the licensor may bring an infringement suit against the licensee, there is

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245. *Id.* at 995.
246. *Id.* at 994.
247. *Id.* at 995 (first emphasis in original) (second emphasis added).
no reason why parties should not be able to negotiate for license provisions that allow a licensor to terminate the license when a licensee sues for invalidity but simultaneously wants to continue the license in case it loses the suit. The Federal Circuit would likely rule, under *Cordis*, that *Lear* “does not permit . . . licensee[s] to avoid facing the consequences that such an action would bring.”\(^\text{251}\) Given the trend of the Federal Circuit, such a holding would be the next logical step towards achieving proper risk allocation between licensors and licensees.

**C. Other Federal Circuit Holdings and Dicta That Strengthen the Enforceability of No-Challenge Termination Clauses**

Not only has the Federal Circuit Court of Appeals supported the enforceability of no-challenge termination clauses by demonstrating that *Lear* has limits and can be subordinate to countervailing policies, some Federal Circuit judges have espoused the policies of innovation and contractual freedom in limiting or attacking the *Lear* rationale. These are the very policies that no-challenge termination clauses promote.\(^\text{252}\)

One such example is *Diamond Scientific Co. v. Ambico, Inc.*\(^\text{253}\) In *Diamond*, the Federal Circuit protected licensors by holding that an inventor who assigned the rights to another (likely to become a licensor since it owns the patent) is estopped from challenging the validity of the patent.\(^\text{254}\) This doctrine is known as “assignor estoppel” and was thought to be invalid under *Lear* and under the cases that *Lear* relied upon.\(^\text{255}\) The court gave little or no weight to the *Lear* policy of preventing “the public [from] continually be[ing] required to pay tribute to would-be monopolists without need or justification,” by encouraging validity challenges.\(^\text{256}\) Instead, the Federal Circuit attempted to distinguish *Lear*, stating that the policy of “allowing a licensee” to challenge validity was not present, for the challenger was an assignor, not a licensee. This logic fails, however, because an assignor’s validity challenge contributes just as much to the policy of “full and free competition in the use of ideas which are in reality a part of the public domain”\(^\text{257}\) as a licensee validity challenge does. Evidently, the court de-emphasized the *Lear* policy in order to protect patent owners, for in this case there was no major countervailing policy, such as res judicata, which could be so significant as to limit *Lear*.

Perhaps even more importantly, this de-emphasis of *Lear* policies opened the door for concurring Judge Newman to attack the policy of *Lear* as

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251. *Cordis*, 780 F.2d at 995.
252. See supra notes 103-15 and accompanying text.
254. Id. at 1224-45.
255. Scott Paper Co. v. Marcalus Mfg. Co., 326 U.S. 249 (1945) (holding that the assignor was not estopped from denying the validity of the patent where the assignee sued the assignor for infringement); *Lear*, 395 U.S. at 666.
257. Id.
"outmoded theory" which "disserves the national interest" of encouraging innovation:

Much attention has been given to encouraging investment in research and commercialization of new products, and in providing incentives to offset the risk inherent in... strengthening incentives for innovation[.] I believe that both public policy and experience weigh on the side of reaffirming the contractual integrity of patent assignments.

... The Court in Lear apparently believed that "full and free competition" ensues when a patent is eliminated from the rolls. The experience of the marketplace is otherwise. The usual incentive to the patent licensee in taking the license is, and always has been, the opportunity for profit. If the destruction of a licensed patent would... facilitate the entry of competitors, this would surely be weighed by a licensee before... a... challenge to the licensed patent.

... Patent rights are indeed vested with strong elements of public interest, but this does not exclude giving due weight to all the interests involved. ... I would decline to give sustenance to a theory of public policy that both weakens the rule of law and disserves the national interest.258

Thus, it appears that in Diamond, at least one Federal Circuit judge was prepared to abandon Lear altogether in order to promote national innovation policy and the others were willing to limit the celebrated policy of Lear without even mentioning countervailing policies.259

The Federal Circuit limited Lear two more times in the year after Diamond, but this time the court stressed the goal of contractual freedom in patent transactions. First, in Sun Studs, Inc. v. ATA Equipment Leasing, Inc.260 the Federal Circuit held that Lear does not bar enforcement of a contractual promise of a non-licensee to not challenge the validity of a patent where the contract encouraged "development of technology and invention." The court stated that such provisions must be considered under state contract law in order to preserve "the integrity of contracts" and foster commercial relationships leading to innovation.261

Then, in RCA Corp. v. Data General Corp.,262 a licensor asked the court to interpret Lear as mandating that any failure of licensees to pay royalties during suit is a breach of contract. The Circuit found that such failure to pay royalties could constitute a breach, but such an issue is a matter of state law, not federal law. In doing so, the court elaborated that "Lear does not in fact discuss a licensor's right to royalties... Nor does it deal with a licensor's right to terminate or rescind a license agreement.... Those questions

259. The court's justification for reviving assignor estoppel was grounded in "prevent[ing] unfairness and injustice." Id. at 1224.
261. Id. at 992.
262. RCA, 887 F.2d 1056 (Fed. Cir. 1989).
continue to be matters dependent on particular fact situations, contract provisions, and state contract law." 263

Diamond, Sun Studs, and RCA each reveal that the Federal Circuit Court of Appeals is willing to sidestep Lear for the sake of promoting the national interest in innovation through efficient contractual negotiations. Such a willingness gives no-challenge termination clauses a very good chance of being upheld if they are ever before the Federal Circuit.

CONCLUSION

Unfortunately, licensing attorneys are reluctant to use no-challenge termination clauses in licensing agreements because Lear and its progeny of cases placed the legality of such clauses in jeopardy by striking down the doctrine of "licensee estoppel," no-challenge clauses in contracts and in settlement agreements, consent decrees, and royalty and termination provisions that shifted leverage to licensors. This case law not only threatened the enforceability of no-challenge termination clauses, but also excessively shifted risk onto the licensor, discouraging the important economic tool of innovation.

The Court of Appeals for the Federal Circuit reversed this trend by overruling much of the Lear progeny of cases. Some Federal Circuit cases went so far as to allow licensors to terminate licenses when the licensee sued for patent invalidity and ceased making royalty payments. Other cases indicate that Lear itself was not a well-reasoned case. The Federal Circuit, however, repeatedly endorsed the narrow holding of Lear, leaving the enforceability of no-challenge termination clauses questionable.

The United States Constitution gave Congress the power to promote the "useful arts," and Congress utilized this power by creating the federal patent laws. As the Framers predicted, innovation has been a key to the economic growth of this country. Now, however, it is critically important, for foreign companies who have become more efficient at producing new technologies are threatening the huge competitive advantage that the United States built during the 1940's and 50's. To stay competitive, America must structure itself in such a way as to encourage innovation.

Modern licensing laws should be oriented toward this goal of encouraging innovation, for licensing is in itself an efficient way to produce, distribute, and promote new technologies. Enforcing no-challenge termination clauses is a way for patent law to serve its constitutional purpose without producing undue societal costs. Under such a provision, a potential patentee would be more likely to innovate, file a patent application, then license the invention, since it would encounter minimal litigation risks. At the same time, licensees would still be free to challenge the validity of patents, supporting the Lear policy of ridding society of invalid patents. Enforcing no-challenge termination clauses would make the efficient tool of licensing even more efficient,

263. Id. at 1064.
and would be a feasible step towards adjusting the legal system to maximize American economic strength.