

VIOLATION OF A PATENT LICENSE RESTRICTION: BREACH OF CONTRACT OR PATENT INFRINGEMENT?

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I. Introduction

In the United States, a patentee's rights are protected by federal statutory law and by state contract law. Under 35 U.S.C. § 154, a patent grants to the patentee the right to "exclude others from making, using, or selling the invention throughout the United States. . . ." A patentee may enforce this right by bringing an action against anyone who makes, uses, or sells the patented invention within the United States during the term of the patent and without authorization from the patentee. [n.1] Since the patent has attributes of personal property, [n.2] the patentee may allow others to exploit the patent. The patentee may grant all rights to the patent by assignment [n.3] or the patentee may grant less than the full set of patent rights by licensing.

The Supreme Court has described a patent license as "a mere waiver of the right to sue." [n.4] The Federal Circuit explains that:

[A] patent license agreement is in essence nothing more than a promise by the licensor not to sue the licensee. . . . Even if couched in terms of "[I]ncensee is given the right to make, use, or sell X," the agreement cannot convey that absolute right because not even the patentee of X is given that right. His right is merely one to exclude others from making, using or selling X, 35 U.S.C. § 154. (Citation omitted). [n.5]

Nevertheless, a patent licensing agreement is a contract which is governed by principles of state contract law. [n.6] For example, a licensor may claim that a licensee's failure to pay royalties resulted in an early termination of the license agreement. In this situation, Chief Justice Taney concluded that the dispute "does not arise under any act of Congress; nor does the decision depend upon the construction of any law in relation to patents. It arises out of the contract. . . ." [n.7]

A patent license may contain a provision which reserves certain uses of the patent for the benefit of the licensor. [n.8] Although the breach of a royalty clause would be resolved under state contract law, the remedy for a breach of a license restriction may be limited to a patent infringement suit in federal court. In certain cases, the licensor may have the option to seek a remedy for a license restriction breach under the contract or from a patent infringement suit. This article examines the rationale behind the variable remedies for a breach of a patent license restriction. In addition, this article explores the

argument that a license restriction implies a covenant by the licensee not to invade the patent rights retained by the licensor. Both issues are illustrated in a license agreement dispute between Genentech and Eli Lilly.

II. Eli Lilly and Co. v. Genentech, Inc.

A. The License Agreement

A license restriction provision may take many forms. One form of license restriction limits the licensee's use of a patented product to a particular market. This type of restriction is illustrated by *General Talking Pictures* [n.9] in which one party was granted a license to use the invention in motion theater projectors while another party was granted a license to use the invention in radio equipment for the home. In addition, the patentee may choose to grant licenses which cover various portions of the patent. This type of restriction is particularly useful in the exploitation of a new process which has numerous potential applications or for a new product which contains useful components. The dispute in *Eli Lilly and Co. v. Genentech, Inc.* [n.10] concerned this type of license restriction.

In a license agreement between Genentech and Eli Lilly, Genentech granted Eli Lilly access to a "recombinant cloning vehicle" which was covered by Claim 6 in Genentech's U.S. Patent No. 4,704,362. [n.11] The recombinant cloning vehicle is a recombinant deoxyribonucleic acid (DNA) molecule which may be used to produce a mammalian protein in bacterial cells. Basically, the cloning vehicle is composed of DNA sequences which code for the mammalian protein and DNA regulatory sequences which provide an efficient production of the mammalian protein in the bacterial cells. [n.12] The Genentech patent describes the use of the DNA regulatory sequences to produce a variety of mammalian proteins. However, Claim 6 is limited to a cloning vehicle composed of DNA regulatory sequences and DNA sequences which code for the human insulin protein. Thus, Eli Lilly could use the genetic material to produce insulin in bacterial cells as an alternative to the isolation of insulin from pancreas glands. The scope of the license was described in clause 6.01 of the license agreement:

Genentech hereby grants to Lilly the exclusive, irrevocable world-wide right with the right to grant sublicenses, to use all Genentech Recombinant [genetic material] for the limited purpose of manufacturing, selling and using Recombinant Insulin without regard to Genentech Patent Rights, and in connection only with such production, sale and use, to use all technical information and know-how supplied by Genentech hereunder. (Emphasis added). [n.13]

Genentech brought an action against Eli Lilly claiming, inter alia, that Eli Lilly's use of the recombinant cloning vehicle exceeded the scope of the limited license. Genentech contended that Eli Lilly used the recombinant cloning vehicle to produce human growth hormone in order to compete with Genentech's human growth hormone product. [n.14] Genentech sought judgment as a matter of law that clause 6.01 of the license agreement

included a covenant by Eli Lilly not to use Genentech's genetic material for non-insulin purposes. Genentech claimed that the production of human growth hormone was beyond the scope of the license and constituted a breach of the contract.

B. Consequences of a License Restriction Breach

The Indiana federal district court concluded that violation of a license restriction does not give rise to an action for breach of contract. The court supported this conclusion with a pronouncement from a Delaware superior court that "[i]f the [licensee] should use the patents over and above the limitation, the [licensor] would have no remedy under the contract but could sue for infringement." [n.15] Although the statement was dictum which the Delaware court did not support with precedent, the concept has a logical appeal as long as the license restriction is viewed in isolation, apart from any other agreement in the license. If a patent license is a promise by the licensor to waive the right to sue for infringement, then the restriction in the Genentech- Eli Lilly agreement may be viewed as a promise by Genentech to waive the right to sue Eli Lilly in the event that Eli Lilly uses the genetic material to produce insulin. Since "a promise to do any specific thing may be translated into a promise to refrain from doing anything else but that" [n.16] specific thing, the license restriction contains an implied negative promise by Genentech that it will not waive the right to sue Eli Lilly for infringement if Eli Lilly uses the genetic material to produce anything but insulin. Therefore, if Eli Lilly uses the genetic material to produce growth hormone, then Genentech may sue for patent infringement.

In contrast, case law shows that a licensor has the option to sue on the contract or to sue for patent infringement when a licensee breaches an express or implied negative covenant in a patent license. In *Pope Manufacturing v. Owsley*, [n.17] an Illinois federal district court found that the defendants had breached a license agreement which contained an express covenant by the licensee not to exceed the license restriction. The court concluded that when the defendants "made machines not in conformity to the licenses, they violated, not only their express covenant not to do so, but also the licensor's patents . . . covering such machines." [n.18] In *Shaw v. E. I. du Pont de Nemours & Co.*, [n.19] the Vermont Supreme court found that the licensee had breached an implied covenant not to exceed the bounds of the license restriction. The licensor "could elect to waive the patent infringement and rely on the defendant's contractual undertaking in the license." [n.20] Similarly, in a case concerning the breach of a restriction in a copyright license, Judge Cardozo explained that:

The author who suffers infringement of his copyright at the hands of a licensee may count upon the infringement as a tort, and seek redress under the statute by action in the federal courts. But that is not in all circumstances the only remedy available. If the same act is not merely an invasion of a statutory right of property, but is also, the breach of a contract or the abuse of a [fiduciary] relation, he may count upon the breach or the abuse, and have relief accordingly. [n.21]

C. The Licensee's Implied Negative Covenant

Thus, breach of a license restriction may give rise to a suit for breach of contract or an infringement suit. In order to have the ability to sue on the contract, the license must contain an express covenant by the licensee not to exceed the restriction or a court must find such a covenant implied in the license. Apparently, the Genentech-Eli Lilly license agreement did not contain an express negative covenant. Furthermore, the court found that a negative covenant could not be implied from the license agreement as a matter of law, particularly in view of the fact that the agreement included an integration clause. However, the court suggested that Genentech may be able to prove that it is "absolutely necessary" to imply a negative covenant by Eli Lilly in order to effectuate the intent of the parties. The court supported the conclusion that the license did not contain an implied negative covenant based upon *General Talking Pictures Corp. v. Western Electric Co.*, [n.22] *Lanova Corp. v. Atlas Imperial Diesel Engine Co.*, [n.23] *Florida Canada Corp. v. Union Carbide & Carbon Corp.*, [n.24] and *B & J Manufacturing Co. v. Hennessy Industries. Inc.* [n.25]

In *General Talking Pictures Corp. v. Western Electric Co.*, [n.26] American Telegraph & Telephone Company had granted licenses which allowed licensees to manufacture and sell a patented amplifier for use in either a "commercial" field (e.g., motion picture equipment) or a "private" field (such as radio equipment for home use). American Transformer Company held a non-exclusive license for the private field which allowed American Transformer "solely and only to the extent and for the uses hereinafter specified and defined . . . to manufacture . . . and to sell only for radio amateur reception, radio experimental reception and radio broadcast reception. . . ." [n.27] Despite the license restriction, American Transformer sold amplifiers to General Talking Pictures for use in theaters as a part of motion picture equipment. Western Electric, an exclusive licensee for the commercial field, brought an action to restrain infringement by General Talking Pictures. The Court found that American Transformer had infringed the patents by knowingly making the sales outside the scope of its license. However, the issue of whether American Telephone & Telegraph (the licensor) could sue American Transformer (the licensee) for a breach of an express or implied covenant in the license agreement was not before the Court.

In *Lanova Corp. v. Atlas Imperial Diesel Engine Co.*, [n.28] Lanova had granted a license to Atlas-Thornberg Diesel Engines, Inc., which assigned its rights under the license to Atlas Imperial. Lanova had granted to the licensee a non-exclusive right to manufacture diesel engines and replacement parts "said license being limited to stationary, marine, industrial and automotive engines with a piston displacement of more than 1000 cubic inches, aeroplane and passenger car engines excepted." [n.29] Lanova brought an action to recover royalties under the license.

If Atlas Imperial could have convinced the Delaware superior court to declare the patents invalid, then Atlas Imperial would have been excused from paying royalties under a provision of the license agreement. However, at this time a licensee was estopped to deny the validity of patents included in a license agreement. [n.30] Atlas Imperial argued that the estoppel doctrine should not apply when the license violated antitrust law. In a

circular argument, Atlas Imperial claimed that the license violated antitrust law because the license restricted the right of Atlas Imperial to manufacture and sell engines of any kind or size and that this restriction was not based upon a valid patent monopoly. In this view, the license restriction was "nothing more than an attempt to deprive the licensee of a privilege he already has, namely: the right to use the process of a void patent for any lawful purpose whatsoever." [n.31]

The court concluded that the license did not violate antitrust law because the license did not prohibit Atlas Imperial from using the potential art to manufacture certain engines. According to the court, the license merely bound Atlas to pay for a limited use without fear of being sued for infringement; the license limitations did not imply a negative covenant. The court conceded that a license restriction implies a negative covenant "in many types of contracts where the very nature of the restriction necessarily implies such a covenant." [n.32] In this case, by declining to imply a negative covenant, the court avoided potential antitrust issues, avoided a novel method to overcome licensee estoppel, and upheld the license agreement.

In *Florida Canada Corp. v. Union Carbide & Carbon Corp.*, [n.33] Florida Canada Corp. had granted a license to use its patented process for the production of high octane motor fuels and chemical intermediates (the "Gyro Process"). According to the agreement, the licensee company (which later merged with Union Carbide) was to use the Gyro Process in a plant to be constructed in South Charleston, West Virginia. Furthermore, the plant was to be designed for a capacity of 1000 barrels of oil input per day.

Seventeen years later, Florida Canada Corp. brought suit against Union Carbide over an accounting of royalties. Union Carbide had constructed additional facilities in close proximity to the South Charleston plant. Florida Canada Corp. claimed that the new facilities were a part of the original plant and therefore, daily capacity had increased beyond 1000 barrels of oil input. The parties resolved the dispute with a settlement contract under which Union Carbide paid for a full release of all claims asserted by Florida Canada Corp. in pending litigation and for all claims arising from the license agreement. At this time, the license agreement was declared terminated. Union Carbide was also released from all claims "whether by way of royalty or otherwise, based on or arising out of any operation or other use which Union Carbide may hereafter make of the [South Charleston] Plant and other facilities as now existing or as hereafter repaired, remodeled or improved up to the present capacity thereof." [n.34]

After another seventeen years, Florida Canada Corp. brought an action for breach of contract alleging, inter alia, that Union Carbide used the Gyro Process in a large number of new plants. The Sixth Circuit agreed with Union Carbide that the settlement contract dealt only with the use of the Gyro Process in the South Charleston plant and that the contract did not prohibit the use of the process in any other plant built or operated by Union Carbide. The court observed that the contract did not contain an express provision prohibiting Union Carbide from using the process at other plants. Furthermore, the court refused to imply such a prohibition since the contract contained an integration clause. The

court's conclusion seems clear since the intent of the settlement contract was to resolve a dispute concerning facilities at the South Charleston location. [n.35]

In *B & J Manufacturing Co. v. Hennessy Industries, Inc.*, [n.36] B & J filed an infringement action against Hennessy alleging that Hennessy had exceeded the scope of their license agreement. According to the license agreement:

[B & J] hereby grants to [Hennessy] a nonexclusive license on the terms and conditions hereinafter set forth to make, have made, use and sell Tire Mounting Machines incorporating bead seating and inflation apparatus claimed in the following Patents and Patent Applications. (Original emphasis). [n.37]

B & J contended that the license was limited to the use of their inventions in Hennessy's new "inflat-air tire changers" and that the license did not grant the right to make "inflat-air kits" which were used to adapt previously sold tire changers. Hennessy argued that the phrase "new machines" did not appear in the license and therefore, the license was not limited to any particular use of the invention. In the alternative, Hennessy argued that even if the license did not include the production of the inflat-air kits such production was not a breach of the license agreement.

Since Hennessy executives admitted that they had not bargained for the right to use the invention in the inflat-air kits, the Illinois federal district court decided that Hennessy could not use a license defense in the infringement suit. However, the court concluded that production of the kits did not breach the license agreement. This conclusion was based upon the lack of an express provision prohibiting production of the kits and the presence of an integration clause. B & J argued that the circumstances surrounding execution of the agreement show that a negative covenant should be implied in the license's narrow grant of patent rights. The court found that an implied negative covenant was not absolutely necessary to effectuate the parties' intentions as a matter of law. Moreover, the court found that the evidence indicated that the intent of the parties was to delineate what Hennessy could do under the license and did not prohibit Hennessy from doing anything.

In summary, *General Talking Pictures*, *Lanova Corp.*, and *Florida Canada Corp.* may be distinguished from the facts in *Eli Lilly*. *B & J Manufacturing* was the only case cited in *Eli Lilly* where a court refused to imply a negative covenant in a license agreement which the licensor claimed had been breached by the licensee. In forming this conclusion, the *B & J Manufacturing* court considered the language of the license restriction, evidence that the parties had not considered a prohibitory provision, and the presence of an integration clause in the agreement. The *Eli Lilly* court also refused to imply a negative covenant as a matter of law after considering the license restriction language and noting the presence of an integration clause. It is difficult to assess the significance, if any, of the integration clause in *B & J Manufacturing* and in *Eli Lilly*. An integration clause need not have a conclusive effect to prevent the introduction of extrinsic evidence to show the parties' intent. [n.38] In fact, the *B & J Manufacturing* court had considered evidence of the parties' intent and the *Eli Lilly* court did not grant *Genentech* summary judgment because

"the facts regarding the parties' intent in drafting § 6.01 are in dispute and not yet fully developed." [n.39]

III. Implied Covenants and the Duty of Good Faith

A court could decide that an integration clause should prevent consideration of extrinsic evidence for an implied negative covenant. Even so, the "duty of good faith and fair dealing" [n.40] in combination with the license restriction may be sufficient to convince a court to imply the covenant. According to the Restatement (Second) of Contracts § 205 "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Comment a of § 205 explains that this duty "emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party" Courts have found an implied negative covenant in copyright licenses based upon the duty of good faith and fair dealing.

In 1899, Harper brothers had granted Klaw & Erlanger an exclusive license to produce a "dramatic version" of Ben Hur. Fourteen years later, the licensor brought action to restrain the licensee from producing a motion picture version of the play, arguing that the production would infringe the copyright. Further, the licensor claimed that since the licensee cannot produce the motion picture, the right to make a film version of Ben Hur must exist in the un conveyed portion of the copyright. The New York federal district court found that the possibility of a motion picture version of Ben Hur had not been considered by the parties in 1899 because it was beyond the technical capability of the nascent motion picture industry. Nevertheless, the court concluded that:

[T]here is implied a negative covenant on the part of the [licensor] . . . not to use the ungranted portion of the copyright estate to the detriment, if not destruction, of the licensee's estate. Admittedly, if [either party] permitted photo-plays of Ben Hur to infest the country, the market for the spoken play would be greatly impaired, if not destroyed. This being the fact, the law is analogous to that which implies, from a covenant to make a certain use of property, a covenant negative against doing anything else with it. [n.41]

In a similar case, Justice Holmes agreed with Harper Bros. and found an implied covenant that a licensor would not destroy the value of the limited right granted by a copyright license. [n.42]

In more recent cases, courts have found an implied reciprocal duty between the licensor and the licensee. In *County of Ventura v. Blackburn*, [n.43] Blackburn had granted the County the right to reproduce, use, and sell his map. The Ninth Circuit held that the County was bound by an implied covenant in the copyright license which required the County to affix copyright notices to each map reproduced by the County. The court agreed with the district court's conclusion that the license "contains implied covenants on the part of the licensee not to use the portion of the copyright estate not granted to it by said contract to the detriment or to the destruction of the copyright estate. . . ." [n.44] Furthermore, the Ninth Circuit agreed with the lower court's conclusion that the license implicitly required the licensee to exercise good faith in performance of the license

agreement and "to do nothing whatsoever that would injure or destroy the value of the copyright to the licensor and that the licensor, reciprocally has the same duty to the licensee with respect to the subject matter of said contract." [n.45]

In *SAS Institute, Inc. v. S & H Computer Systems*, [n.46] SAS Institute licensed S & H to use a copyrighted computer program system for performing statistical analysis on an identified IBM computer in the Tennessee State University at Nashville. According to the agreement, S & H could modify the program, but only for its own use. SAS Institute brought action against S & H alleging, inter alia, that S & H had breached the license by using the program to produce a version compatible with VAX computers. S & H argued that it had "never agreed, impliedly or expressly, not to produce a piece of statistical software designed to operate on VAX Computers. . . ." [n.47] However, the Tennessee federal district court held that S & H had violated an implied covenant in the license agreement. The court concluded that S & H "did agree as a matter of law not to use proprietary SAS materials in the process, as it did. S & H's conduct cannot be said to comply with its legal duty of good faith and fair dealing." (Original emphasis). [n.48]

The Vermont Supreme Court has applied the reasoning of the copyright license cases to imply a negative covenant in a patent license. In *Shaw v. E. I. du Pont de Nemours & Co.*, [n.49] Shaw had granted Du Pont a license under his patent for an "artificial filament" in which Du Pont was "to make, use, and/or sell filaments having, in the drawn state, a maximum cross-sectional dimension of not more than 5 mils (.005 inches). . . ." [n.50] Shaw brought an action in contract alleging that Du Pont had manufactured a product with a cross-sectional dimension greater than five mils. Du Pont argued, inter alia, that the license had not imposed an agreement not to manufacture filaments with a cross-sectional dimension in excess of five mils.

The Vermont Supreme court affirmed the trial court's holding that Du Pont was bound by a negative covenant implied from the license agreement. The court found that:

It is clear from the language of the license that the plaintiff patentee reserved for himself, or his assignee, the property in the patent as to all filaments in excess of the dimension specified. . . . The implication that the defendant is not to exceed the limits of his license is not external to the license agreement. It is an inference which follows from the language of the parties and becomes as much a part of the contract as if it were spelled out in explicit terms. [n.51]

Further, the court cited *Manners v. Morosco* [n.52] in explaining that "it is the implied assumption from the language that the defendant would not operate outside the limits of his license to the detriment of the patent rights reserved by the licensor." [n.53] After a rehearing, the court reaffirmed the holding and stated that "when permission is granted to operate in a restricted area, the acceptance of the privilege implies a condition that the area reserved will not be invaded." [n.54]

IV. Implied Covenant Rationale and the Patent License

Shaw and Eli Lilly analyzed similar license restrictions with different results. In Shaw, the license granted the right "to make, use, and/or sell filaments having . . . a maximum cross-sectional dimension of not more than 5 mils (.005 inches). . . ." [n.55] While in Eli Lilly, the license granted the right "to use all Genentech Recombinant genetic material for the limited purpose of manufacturing, selling and using Recombinant Insulin. . . ." [n.56] Presumably, the obligation of good faith and fair dealing, which may be traced to the treatises of Cicero, [n.57] applied to both license agreements. Yet, a negative covenant was implied in Shaw, but not in Eli Lilly.

The variation in results may be explained by considering the rationale behind an implied negative covenant. Corbin observed that "considerations of equity and morality play a large part in the process of finding a promise by inference of fact. . . ." [n.58] In *Parev Products Co. v. I. Rokeach & Sons*, [n.59] Judge Clark suggested that equity is the predominant consideration behind the implication of a covenant. Judge Clark noted that:

[I]n the precedents we are met at once with the confusion of statement whether a covenant can be implied only if it was clearly "intended" by the parties, or whether such a covenant can rest on principles of equity. Expressions can be found which insist on "intention" . . . which seem to combine both a requirement of "intention" and of "equity and justice" . . . and which by-pass "intention" and rely solely on equity. . . . One may perhaps conclude that in large measure this confusion arises out of the reluctance of courts to admit that they were to a considerable extent "remaking" a contract in situations where it seemed necessary and appropriate so to do. "Intention of the parties" is a good formula by which to square doctrine with result. That this is true has long been an open secret. (Citations omitted). [n.60]

More recently, a commentator observed that "[t]he 'implication' of a condition or promise in contracts has long been recognized as a branch of or substitute for the doctrine of good faith. . . but in recent years and in part because of the influence of the Uniform Commercial Code, it has become more fashionable for courts to talk of 'good faith' than of 'implied covenants.'" [n.61]

If a court is "constrained to imply the covenant because of the court's own notions of morality or 'fair play,'" [n.62] then it is not unlikely that two courts will draw different conclusions from similar fact patterns. Furthermore, the idea that a court is primarily motivated by a principle of "equity and justice" to find an implied covenant, suggests that a court may be more willing to find such a covenant in a contract than in a patent license agreement where the licensor has the optional remedy of a patent infringement suit. In fact, the *B & J Manufacturing* court noted that "it is not as if the plaintiff will lose any rights by the court's failure to imply such a negative covenant since the plaintiff can, as it has, sue for patent infringement on those items manufactured outside the license grant." [n.63] Moreover, this attitude suggests that a court may demand a clearer expression of a negative covenant in the language of a patent license agreement than in the language of a contract.

V. Conclusion: Express Negative Covenant Language

After a rehearing of *B & J Manufacturing*, [n.64] the court suggested the type of language which would unambiguously indicate that the licensee is not to invade patent rights retained by the licensor. The court explained that "when one is granted a license to do X, it is understood that one will only do X. Of course, the licensee's recognition of the truth does not show that anyone regarded the doing of 'not-X' . . . as a breach of the license agreement." (Original emphasis). [n.65] Thus, the court suggested the use of three provisions: 1) the grant of the restricted license by the licensor; 2) a return promise by the licensee not to go beyond the bounds of the limited license; and 3) an agreement that such action by the licensee would constitute a material breach of the license.

For example, suppose that the Genentech-Eli Lilly agreement contained three provisions. First, a provision which granted to Eli Lilly the right to use the genetic material to produce only insulin. Second, a provision in which Eli Lilly promised to refrain from using the genetic material for any purpose but insulin production. Third, a provision which stated that a breach of the negative covenant would be a material breach of the license agreement. In this situation, Eli Lilly's use of the genetic material to produce growth hormone would be a violation of the license restriction (licensor's promise) which gives rise to a patent infringement suit and a breach of the negative covenant (licensee's promise) which gives rise to an optional action under the contract.

The licensee's negative covenant is actually a promise by the licensee not to infringe the patent rights retained by the licensor. [n.66] The express covenant not to infringe is illustrated by *United Lens Corporation v. Doray Lamp Co.* in which the licensee "agreed that it will not infringe either directly or indirectly any of the claims of" certain patents. [n.67] In this case, the Seventh Circuit could find "no reason why one individual may not validly contract to . . . agree during the life of said patent not to infringe its claims." [n.68] In addition, federal courts have interpreted a patent license restriction as a valid agreement not to infringe when the licensee has claimed that the license violated antitrust law. [n.69] An Illinois federal district court has even suggested that a licensee's promise not to infringe may be implied in a patent license agreement. [n.70] Although a claim for patent infringement arises under federal law, the licensor may sue under the contract when the licensee breaches a covenant not to infringe. [n.71]

In conclusion, the breach of a patent license restriction gives the licensor the right to sue the licensee for patent infringement. The licensor will have the option to sue under the contract if the agreement contains the licensee's negative covenant. The licensee may expressly promise to refrain from using the patent for certain purposes or the licensee may expressly promise not to infringe the patent rights retained by the licensor. If a license agreement lacks an express negative covenant, a court may imply the covenant based upon an "inference which follows from the language of the parties" [n.72] or based upon the duty of good faith. Since it may be difficult to convince a court that equity demands implication of the negative covenant, the license should contain an express negative covenant which is distinct from the license restriction.

Does the breach of contract approach to a license restriction violation circumvent federal policy for patent regulation? Consider an extreme case in which a state court must decide whether a licensee breached a covenant not to infringe the licensor's patent. In this case, the state court must compare the licensee's activities with the scope of the licensor's patent. At the same time, 28 U.S.C. § 1338(a) provides that federal "district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents." Nevertheless, the Federal Circuit has found that although "[t]he scope of a licensed patent may control the scope of a license agreement, . . . that rule of contract law cannot possibly convert a suit for breach of contract into one 'arising under' the patent laws." [n.73] Moreover, the Supreme Court has stated that patent rights may be enforced under state law, as long as state law does not conflict with federal law. [n.74] Thus, a breach of contract claim in an alleged license restriction violation is consistent with the policy of parallel enforcement of patent rights under federal and state law. [n.75]

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[n.1]. 35 U.S.C. § § 271, 281 (1989).

[n.2]. 35 U.S.C. § 261.

[n.3]. *Id.*

[n.4]. *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, 181 (1938) (quoting *De Forest Radio Teleph. & Teleg. Co. v. United States*, 273 U.S. 236, 242 (1927); *Accord, United States v. Studiengesellschaft Kohle, m.b.H.*, 670 F.2d 1122, 1127 (D.C.Cir.1981) ("A license is an agreement by the patentee, usually for a consideration, not to sue the licensee of the patent for infringement of the patent.").

[n.5]. *Spindelfabrik Suessen-Schurr v. Schubert & Salzer*, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. denied, 484 U.S. 1063 (1988).

[n.6]. *Sun Studs, Inc. v. Applied Theory Associates, Inc.*, 772 F.2d 1557, 1561 (Fed.Cir.1985); *Power Lift, Inc. v. Weatherford Nipple-Up Systems*, 871 F.2d 1082, 1085 (Fed.Cir.1989).

[n.7]. *Wilson v. Sandford et al.*, 10 How. 99, 101 (1850).

[n.8]. The license restriction must not extend the scope of the patent monopoly. *General Talking Pictures*, 304 U.S. at 181. One commentator suggests that this condition is satisfied when: 1) the licensor possess patent rights to the subject matter of the license; and 2) the restriction is used only to exclude the licensee from practicing all or part of the licensor's patent rights. S.Z. SZCZEPANSKI, *ECKSTROM'S LICENSING IN FOREIGN AND DOMESTIC OPERATIONS* 3-19 (1991).

[n.9]. 304 U.S. 175 (1938), *aff'd on reh'g*, 305 U.S. 124 (1938), *reh'g denied*, 305 U.S. 675 (1939).

[n.10]. 17 U.S.P.Q.2d 1531 (S.D.Ind. 1990).

[n.11]. This fact was noted in: *University of California v. Eli Lilly & Co.*, 777 F.Supp. 779, 781, 19 U.S.P.Q.2d 1668, 1669 (N.D.Cal. 1991).

[n.12]. The recombinant cloning vehicle may be visualized as a computer program in which the protein coding sequences provide a subprogram for output. The output of the complete program will depend upon the particular subprogram in use.

[n.13]. *Eli Lilly*, 17 U.S.P.Q.2d at 1533.

[n.14]. This could be accomplished by replacing the insulin DNA sequences with growth hormone DNA sequences.

[n.15]. *Lanova Corp. v. Atlas Imperial Diesel Engine Co.*, 55 A.2d 272, 275, 75 U.S.P.Q. 225, 228 (Del.Super.Ct. 1947).

[n.16]. 11 S. WILLISTON, *A TREATISE ON THE LAW OF CONTRACTS* § 1448 (W.H.E. Jaeger 3d ed. 1968).

[n.17]. 27 F.100 (C.C.N.D.Ill. 1886).

[n.18]. Pope Manufacturing, 27 F.100 at 104. See also Magic Ruffle Co. v. Elm City Co., 16 F.Cas. 399, 401 (C.C.D.Conn. 1875) (No. 8,949) ("[T]he [licensors] could resort to an action at law or in equity, to obtain redress of this violation of their exclusive patent rights. . . . And, if the licensees have also expressly covenanted, in their agreement of license, that they . . . will not use the invention for a particular purpose, a violation of such covenant is also a breach of contract . . .") (citations omitted); Cf. Henry v. A.B. Dick Co., 224 U.S. 1 (1912) concerning a license restriction under which a patented machine was to be used only with certain supplies provided by the patentee. The Supreme Court found that a breach of a license restriction gave rise to either a breach of contract claim or a patent infringement claim. (Henry v. A.B. Dick Co. was overruled on other grounds by Motion Picture Co. v. Universal Film Co., 243 U.S. 502, 518 (1917)).

[n.19]. 226 A.2d 903, 152 U.S.P.Q. 364 (Vt. 1966).

[n.20]. Id. at 905, 152 U.S.P.Q. at 366.

[n.21]. Underhill v. Schenck, 143 N.E. 773, 775 (N.Y. 1924).

[n.22]. 304 U.S. 173 (1938), aff'd on rehearing, 305 U.S. 124 (1938).

[n.23]. 55 A.2d 272, 75 U.S.P.Q. 225 (Del.Supr.Ct. 1947).

[n.24]. 280 F.2d 193 (6th Cir.1960), cert. denied, General Development Corp. v. Union Carbide & Carbon Corp., 364 U.S. 902 (1960).

[n.25]. 194 U.S.P.Q. 496 (N.D.Ill. 1976), 206 U.S.P.Q. 542 (N.D.Ill. 1979), aff'd, 663 F.2d 1075 (7th Cir.1981), cert. denied, 454 U.S. 1086 (1981).

[n.26]. General Talking Pictures Corp., 304 U.S. 175.

[n.27]. General Talking Pictures Co., 305 U.S. at 126.

[n.28]. 55 A.2d 272, 75 U.S.P.Q. 225 (Del.Supr.Ct. 1947).

[n.29]. Lanova Corp., 55 A.2d at 272, 75 U.S.P.Q. at 226.

[n.30]. The Supreme Court abolished licensee estoppel in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

[n.31]. Lanova Corp., 55 A.2d at 274, 75 U.S.P.Q. at 227.

[n.32]. Lanova Corp, 55 A.2d at 276, 75 U.S.P.Q. at 229.

[n.33]. 280 F.2d 193, 126 U.S.P.Q. 163 (6th Cir.1960).

[n.34]. Florida Canada Corp, 280 F.2d at 194, 126 U.S.P.Q. at 164.

[n.35]. According to the *Eli Lilly* court, Florida Canada Corp. stands for the proposition that "[n]o negative covenant should be implied as a matter of law in a limited license of patents and trade secrets, especially when the license includes an integration clause." *Eli Lilly*, 17 U.S.P.Q.2d at 1534.

[n.36]. 194 U.S.P.Q. 496 (N.D.Ill. 1976).

[n.37]. *Id.* at 497.

[n.38]. See, e.g., *Sutton v. Stacey's Fuel Mart, Inc.*, 431 A.2d 1319, 1322 (footnote 3) (Me. 1981) ("A merger clause does not control the question of whether the writing was intended to be a completely integrated agreement."); *Franklin v. White*, 493 N.E.2d 161, 166 (Ind. 1986) ("An integration clause is only some evidence of the parties' intentions."); RESTATEMENT (SECOND) OF CONTRACTS § 216 comment e (1981). ("But such a [merger] clause does not control the question whether the writing was assented to an integrated agreement, the scope of the writing if completely integrated, or the interpretation of the written terms.").

[n.39]. *Eli Lilly*, 17 U.S.P.Q.2d at 1535.

[n.40]. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

[n.41]. Harper Bros. v. Klaw, 232 F. 609, 613 (S.D.N.Y. 1916).

[n.42]. Manners v. Morosco, 232 U.S. 317 (1920). (Licensor brought action to restrain licensee from producing a motion picture of a copyrighted play).

[n.43]. 362 F.2d 515, 150 U.S.P.Q. 160 (9th Cir.1966).

[n.44]. County of Ventura, 362 F.2d at 518, 150 U.S.P.Q. at 163.

[n.45]. Id.

[n.46]. 605 F.Supp. 816, 225 U.S.P.Q. 916 (M.D.Tenn. 1985).

[n.47]. 605 F.Supp. at 828, 225 U.S.P.Q. at 925.

[n.48]. Id.

[n.49]. 226 A.2d 903, 152 U.S.P.Q. 364 (Vt. 1966).

[n.50]. Shaw, 226 A.2d at 905, 152 U.S.P.Q. at 365.

[n.51]. 226 A.2d at 906, 152 U.S.P.Q. at 367.

[n.52]. 232 U.S. 317 (1920).

[n.53]. Shaw, 226 A.2d at 906, 152 U.S.P.Q. at 367.

[n.54]. Shaw, 226 A.2d 903, 152 U.S.P.Q. 723 (Vt. 1967).

[n.55]. Shaw, 226 A.2d at 905, 152 U.S.P.Q. at 365.

[n.56]. Eli Lilly, 17 U.S.P.Q.2d at 1533.

[n.57]. 3A CORBIN ON CONTRACTS § 654A (1963 & Supp.1991).

[n.58]. 1 CORBIN ON CONTRACTS § 19 (1963).

[n.59]. 124 F.2d 147 (2d Cir.1941).

[n.60]. Parev Products, 124 F.2d at 149. In fact, a court may go beyond the "intention of the parties" by attaching "many obligations which were not in the minds of the parties . . . a contract creates a status which imposes such obligations because of considerations of policy." (Footnote omitted). *M. Witmark & Sons v. Fred Fisher Music Co.* 125 F.2d 949, 962 (2nd 1942) (Frank, J., dissenting), *aff'd*, 318 U.S. 643 (1943).

[n.61]. 3 CORBIN ON CONTRACTS § 561 (1963 & Supp.1991).

[n.62]. *So Good Potato Chip Company v. Frito-Lay, Inc.*, 462 F.2d 239, 241 (8th Cir.1972).

[n.63]. 194 U.S.P.Q. 496, 499 (N.D.Ill. 1976).

[n.64]. 493 F.Supp. 1105, 206 U.S.P.Q. 542 (N.D.Ill. 1979).

[n.65]. *Id.* at 1132, 206 U.S.P.Q. at 566.

[n.66]. Theoretically, federal statutory law could prohibit the intentional infringement of a patent. Since statutory law grants a patentee the right to prevent infringement, instead of imposing the obligation on others not to infringe, the licensee's covenant not to infringe avoids conflict with the "preexisting duty rule." *RESTATEMENT (SECOND) OF CONTRACTS* § 73 (1981). ("Performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration. . . .").

[n.67]. 93 F.2d 969, 972 (7th Cir.1937); Accord, American Box Mach. Co. v. Crossman, 57 F. 1021 (C.C.D.Mass. 1892), aff'd, 61 F.888 (1st Cir.1894); Reese Folding Mach. Co. v. Earl & Wilson, 205 F. 536 (N.D.N.Y. 1913); Daniels v. Brown Shoe Co., 77 F.2d 899 (1st Cir.1935); Cf. Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co., 444 F.2d 425, 428 (9th Cir.1971), cert. denied, 404 U.S. 873 (1971), reh'g denied, 404 U.S. 961 (1971) (covenant not to infringe in settlement contract between patentee and a party who was not a licensee).

[n.68]. United Lens Corp., 93 F.2d at 973.

[n.69]. E.g., Steiner Sales Co. v. Schwartz Sales Co., 98 F.2d 999, 1011 (10th Cir.1938), cert. denied, 305 U.S. 662 (1938) ("An agreement by a licensee not to infringe the patent covered by the license is valid.") (footnote omitted); Baldwin-Lima-Hamilton Corp. v. Tatnell Meas. Sys. Co., 169 F.Supp. 1, 26 (E.D.Penn. 1958), aff'd, 268 F.2d 395 (3rd Cir.1959), cert. denied, 361 U.S. 894 (1959) ("[A]n agreement to refrain from infringement is beyond the reach of the Clayton Act."); Deering, Milliken & Co. v. Temp-Resisto Corp., 160 F.Supp. 463, 480 (S.D.N.Y. 1958), aff'd in part and rev'd in part, 274 F.2d 626 (2nd Cir.1960) ("A license giving to the licensor the right to terminate the license if the licensee infringes the licensed patent is not illegal.").

[n.70]. Robb Container Corp. v. Sho-Me Co., 566 F.Supp. 1143 (N.D.Ill., E.D. 1983).

[n.71]. E.g., American Box Mach. Co., 57 F. 1021 (breach of contract or patent infringement); Daniels, 77 F.2d 899 (breach of contract); United Lens Corp., 93 F.2d 969 (breach of contract or patent infringement); Cf. Massillon-Cleveland-Akron Sign Co., 444 F.2d 425 (breach of settlement contract).

[n.72]. 226 A.2d 903, 906, 152 U.S.P.Q. 364, 367 (Vt. 1966).

[n.73]. Ballard Medical Products v. Wright, 823 F.2d 527, 530 (Fed.Cir.1987).

[n.74]. Kewanee Oil Company v. Bicron Corporation, 94 S.Ct. 1879, 1885 (1974); Bonito Boats Inc. v. Thunder Craft Boats Inc., 489 U.S. 141, 152, 9 U.S.P.Q.2d 1847, 1852 (1989).

[n.75]. In fact, a licensor may be able to obtain the same range of remedies in state court for the breach of a license agreement that the licensor would be able to obtain in federal

court for patent infringement under 35 U.S.C. § § 283-285 (i.e., an injunction, compensatory damages, and attorney fees). *In re Oximetrix, Inc.*, 748 F.2d 637 (Fed.Cir.1984).