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## From License to Restraint: Challenging the No-Challenge Clause in Patent Licenses – Part I

By John Kappos and Bo Moon

### I. INTRODUCTION

Clauses that bar a licensee from challenging the validity of licensed patents (no-challenge clauses) are common in patent license agreements, including those in litigation settlements. No-challenge clauses bar a licensee from challenging the validity of the licensed patents in court or in an administrative proceeding, and often also prevent the licensee from assisting others in doing so.

Though no-challenge clauses are common, their enforceability is still subject to debate. Not only will these clauses need to be interpreted in any dispute on enforceability, but also the outcome may differ depending on factors extrinsic to the four corners of the agreement, e.g., choice of law, whether the license is a post-litigation settlement agreement, and whether the case includes patent infringement claims.

This two-part article examines those factors based on the Supreme Court's and the circuit courts' caselaw.

In this first part, this article discusses *Lear V. Adkins* and its expansion, and the circumstances under which a no-challenge clause is enforceable. The conclusion of this article, which will be published in the next issue of the *Intellectual Property & Technology Law Journal*, will explore the Patent Trial and Appeal Board's disregard of no-challenge clauses, the federal courts' response and the governing law.

### II. LEAR V. ADKINS AND ITS EXPANSION

The Supreme Court's decision in *Lear v. Adkins*<sup>1</sup> remains the case that is almost always discussed, applied, or distinguished when confronted with a no-challenge clause. In *Lear*, an engineer named John Adkins (Adkins) developed a method for constructing gyroscopes.<sup>2</sup> He entered into a licensing agreement with Lear, Inc. (Lear), which provided that Lear could terminate the license if no patent had issued or if the issued patent was held invalid.<sup>3</sup> While the application was pending, Lear stopped paying royalties after discovering anticipatory prior art but continued to manufacture and sell the licensed subject matter. When the patent finally issued, Adkins sued in California state court under contract for royalties.<sup>4</sup> In its defense,

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The authors, attorneys with O'Melveny & Myers LLP, may be contacted at [jkappos@omm.com](mailto:jkappos@omm.com) and [bmoon@omm.com](mailto:bmoon@omm.com), respectively.

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Lear asserted that Adkins's patent was invalid.<sup>5</sup> The Supreme Court of California ruled that Lear could not attack the validity of the patent under the doctrine of licensee estoppel, which "establishe[d] that so long as a licensee is operating under a license agreement, he is estopped to deny validity of his licensor's patent in a suit for royalties under the agreement."<sup>6</sup> The U.S. Supreme Court set aside the estoppel, citing "an important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain."<sup>7</sup>

Although *Lear* involved licensee estoppel rather than a contract with an explicit no-challenge clause, the balancing test established in *Lear* became the rationale for finding a no-challenge clause unenforceable even in a case where the parties had agreed (as part of the consideration exchanged) to forfeit any right to contest the patent's validity. Some courts have considered *Lear* "notable not only for its particular holdings regarding the doctrine of licensee estoppel and the enforcement of contracts for royalties, but also for establishing a 'balancing test' for weighing the public interest in discovering invalid patents against other competing interests."<sup>8</sup> Two courts of appeals – the Second Circuit and the Ninth Circuit – have applied the rationale of *Lear* to license agreements with explicit no-challenge clauses.

In *Massillon–Cleveland–Akron Sign Co. v. Golden State Advertising Co.*,<sup>9</sup> a pre-Federal Circuit case from the Ninth Circuit, the court addressed a pre-litigation settlement agreement that included an explicit no-challenge clause. The patent owner threatened a patent infringement action against the defendants. The parties agreed on a written settlement to resolve the dispute before the patent owner filed a legal action. Under the settlement, defendants agreed not to infringe the patent, acknowledged its validity, and pledged not to contest its validity. Six years later, the patent holder accused the defendants again of infringement and filed a lawsuit, alleging breach of the settlement agreement and conspiracy to induce breach of the agreement. Defendants responded by asserting affirmative defenses and a counterclaim that the patent was invalid. Citing *Lear*, the Ninth Circuit determined that the covenant not to contest the patent's validity was null and unenforceable. The court explained that a valid patent was a prerequisite for claiming damages for

inducing a breach of a contract not to infringe and for the breach itself.

More recently, the Second Circuit's decision in *Rates Technology Inc. v. Speakeasy Inc.*<sup>10</sup> repeats the rationale of *Lear* and *Massillon*. Rates Technology Inc. (RTI) was a prolific patent litigant in the telecommunications industry, well known for settling patent claims in exchange for a one-time payment based on the size of the accused infringer's sales. In exchange for the payment, RTI would enter into a settlement agreement styled as a "covenant not to sue."

In 2007, RTI sent a demand letter to Speakeasy, accusing it of infringing two of RTI's patents for automatic routing of telephone calls. The companies settled the dispute with Speakeasy paying \$475,000 to RTI in exchange for a license styled as a covenant not to sue. As a result, RTI did not file litigation based on alleged patent infringement. The licensing agreement included a provision barring Speakeasy from challenging the validity of RTI's patents or assisting others in validity challenges. This no-challenge clause was accompanied by a liquidated damages clause that called for Speakeasy to pay \$12 million to RTI if Speakeasy were to breach the no-challenge provision. In 2010, Speakeasy was acquired by Covad Communications. Soon after, RTI accused Covad of infringing the same patents subject to RTI's settlement agreement with Speakeasy. Before RTI could initiate litigation though, Covad filed a declaratory judgment action in California seeking to invalidate the patents-at-issue. RTI responded by suing Speakeasy in New York, alleging that Speakeasy gave Covad information to aid Covad's declaratory judgment action – a violation of the no-challenge clause. Covad dismissed its California declaratory judgment action, and only RTI's New York suit remained. U.S. District Judge Denise Cote dismissed the case in May 2011, finding that the no-challenge clause was void under *Lear*. RTI appealed to the Federal Circuit, and the Federal Circuit transferred the case to the Second Circuit.<sup>11</sup>

The Second Circuit held that a no-challenge clause contained in a pre-litigation settlement agreement is unenforceable under *Lear*.<sup>12</sup> In making this finding, the Second Circuit declined to follow the Federal Circuit's 1997 statement in *Baseload Energy, Inc. v. Roberts*<sup>13</sup> that "clear and unambiguous language barring the right to challenge patent

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validity in future infringement actions is sufficient, *even if invalidity claims had not been previously at issue and had not been actually litigated.*<sup>14</sup> The Second Circuit in *Rates* dismissed this statement as dicta,<sup>15</sup> and reasoned that if no-challenge clauses in pre-litigation agreements were held to be valid and enforceable, *Lear's* policy “favoring the full and free use of ideas in the public domain” could be circumvented through craftsmanship. This was because “[c]reating a ‘good faith’ dispute about patent validity that can be ‘settled’ by a license including a covenant never to challenge the patent would rarely be an obstacle to parties seeking to avoid the strictures of *Lear*.”<sup>16</sup> As a result, “allowing such no-challenge clauses whenever a license agreement is cast as a ‘settlement’ could ‘close[] the doors of the courts to a large group of parties who ha[ve] sufficient interest in the patent to challenge its validity.”<sup>17</sup>

### III. CIRCUMSTANCES UNDER WHICH A NO-CHALLENGE CLAUSE IS ENFORCEABLE

While still bound by *Lear*, the Federal Circuit has carved out limited circumstances where it will enforce no-challenge clauses. Through a series of cases, the Federal Circuit has distinguished *Lear*, establishing its own body of precedents.

For example, in *Hemstreet v. Spiegel, Inc.*,<sup>18</sup> the Federal Circuit considered a settlement order from a prior litigation. In 1977, patent owner Hemstreet filed a patent infringement lawsuit against Spiegel, Inc., and Recognition Equipment, Inc. (REI). After a week of trial, the parties reached a settlement, which was memorialized in a “Settlement Order” signed by the district court and the parties’ lawyers. The Settlement Order dismissed the action and stated that “the issues of validity, unenforceability, and infringement of” the patents were “finally concluded and disposed of.”<sup>19</sup> Under the Settlement Order, REI also “agree[d] to make said payments as they become due notwithstanding that said patents-in-suit may be held invalid and/or unenforceable in any other proceeding at a later date[.]”<sup>20</sup> In 1987, REI filed a petition in the district court to be relieved from making further payments because another court had found the patents unenforceable due to Hemstreet’s misconduct.<sup>21</sup> REI argued that it would be inequitable to continue requiring payments for unenforceable patents.

The Federal Circuit held that a dismissal based upon a settlement order in which “‘the issues of validity, enforceability, and infringement of’ the patents in suit were finally concluded and disposed of,” barred a subsequent challenge to the validity and enforceability of those patents by the same party, no matter if the settlement order and dismissal actually adjudicated patent validity to create *res judicata*.<sup>22</sup> The court stated, “[t]here is a compelling public interest and policy in upholding and enforcing settlement agreements voluntarily entered into.” The court reasoned that enforcing settlement agreements encourages parties to enter into them – fostering judicial economy.<sup>23</sup> The Federal Circuit distinguished *Lear*, explaining that *Lear* “did not involve a settlement of litigation, but only the right of a patent licensee to challenge the validity of the licensed patent.”<sup>24</sup> The court found that “[t]he enforcement of settlement of litigation involves another public policy totally absent in *Lear*: the encouragement of settlement of litigation and the need to enforce such settlements in order to encourage the parties to enter into them.”<sup>25</sup>

In *Foster v. Hallco Mfg. Co.*<sup>26</sup> the Federal Circuit reiterated the distinction over *Lear* as articulated in *Hemstreet*. *Foster* concerned a consent decree from an earlier patent infringement litigation.<sup>27</sup> In the consent decree, the accused infringer, Foster acknowledged the validity and infringement of the patents at issue.<sup>28</sup> About four years after the first litigation, Foster began making a new device, and informed the patentee, Hallco, that the device did not infringe the patents at issue in the prior litigation. Hallco disagreed. When Foster subsequently filed a declaratory judgment action that the patents were invalid and unenforceable, Hallco asserted an affirmative defense of *res judicata*, based on the consent decree declaring that the patents were valid and enforceable.<sup>29</sup> Foster argued that, because the consent decree was essentially an agreement not to challenge the patent, it was unenforceable under *Lear*.<sup>30</sup> The Federal Circuit disagreed, explaining that *Lear's* abrogation of licensee estoppel did not change the fact that a consent decree gives rise to *res judicata*.<sup>31</sup> The court repeated *Hemstreet's* holding that there is a strong public interest in settlement of patent litigation and that upholding the terms of a settlement encourages patent-owners to agree to settlements – thus fostering judicial economy. The court further explained that “unlike

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*Lear*, where there was a conflict between federal patent policy and the state law of contracts, here [the Court] ha[s] strong competing policies that do not implicate questions of the primacy of federal over state law.”<sup>32</sup> The competing public policies at issue in *Foster* were the policy in *Lear* which “seeks to outlaw restriction of challenges to validity of patents” versus a policy that “favors the finality of judgments generally and the encouragement of settlements of litigation in particular, including settlements resulting in a consent judgment.”<sup>33</sup> The Federal Circuit declined to apply *Lear*, and remanded the case to the district court to determine the parties’ intent based on the language of the consent judgment.<sup>34</sup>

In *Flex-Foot, Inc. v. CRP, Inc.*,<sup>35</sup> the policy rationale of *Hemstreet* and *Foster* was extended to a private settlement agreement. The parties in *Flex-Foot* had been through two rounds of earlier litigations. In the first, Flex-Foot filed against CRP for infringement of the subject patent in 1989. That case promptly settled and was dismissed through a settlement agreement and a corresponding license agreement in which CRP agreed to pay a royalty on sales of the accused device.<sup>36</sup> Those agreements did not include any provision barring CRP from later challenging the validity of the subject patent.<sup>37</sup> In fact, the license “expressly provided that it would expire upon judicial determination that the [p]atent was invalid.”<sup>38</sup>

In 1993, CRP brought a second action (the DJ action), seeking a declaration that the subject patent was invalid. But in 1994, after discovery, the parties settled the DJ action via another settlement agreement and corresponding license agreement. The 1994 settlement agreement stated that CRP waived its right to challenge the validity and enforceability of the subject patent: “[CRP] agrees not to challenge or cause to be challenged, directly or indirectly, the validity or enforceability of [the patent at issue] in any court or other tribunal, including the United States Patent and Trademark Office.”<sup>39</sup> The license also barred CRP from challenging the validity of the patent-at-issue.<sup>40</sup> Pursuant to the 1994 agreements, the parties entered into a stipulation for dismissal of the DJ action with prejudice.

In 1997, Flex-Foot filed a complaint alleging that some of CRP’s new devices infringed the same patent. Pursuant to the parties’ 1994 agreements, the 1997 complaint was sent to arbitration, in which

Flex-Foot obtained an arbitration award. The award did not address CRP’s challenge to the validity of the patent. After the arbitration award, CRP filed a motion with the district court to vacate the award and consider the invalidity defense. In response, Flex-Foot filed a motion to affirm the arbitration award. The district court granted Flex-Foot’s motion and entered a permanent injunction against CRP, concluding that CRP was “collaterally estopped” from challenging the validity and enforceability of the patent-at-issue. In an ensuing appeal, CRP argued that the no-challenge clause should not be enforced under *Lear*.

As in *Hemstreet* and in *Foster*, the Federal Circuit distinguished *Lear* by pointing out that “[t]he license agreement in *Lear* was not created as part of a litigation settlement”<sup>41</sup> and “did not contain, and was not accompanied by, any promise by the licensee not to challenge the validity of the patent.”<sup>42</sup> Characterizing CRP’s argument as an attempt to “renege on its prior written agreement with Flex-Foot”<sup>43</sup> and “exactly the type of behavior that both *Hemstreet* and *Foster* were concerned with when they noted the strong public interest in enforcing settlements,”<sup>44</sup> the Federal Circuit found the no-challenge clause enforceable. The Federal Circuit explained that its rationale in *Hemstreet* and *Foster* was “relevant to the instant case, even though this case deals with a settlement agreement and resulting dismissal with prejudice, rather than a consent decree.”<sup>45</sup> The public interest in enforcing settlements is furthered by enforcing the no-challenge clause, because “[u]pholding the terms of settlement agreements encourages patent owners to agree to settlements and promotes judicial economy.”<sup>46</sup>

The Federal Circuit again considered a settlement agreement stemming from a prior litigation in *Baseload Energy, Inc. v. Roberts*.<sup>47</sup> The earlier litigation had involved state law breach of contract and no patent claims. The resulting settlement agreement contained a general release in which the licensee, Baseload, agreed to “forever release and discharge [the licensor] of and from any and all losses, liabilities, claims, expenses, demands and causes of action of every kind and nature,”<sup>48</sup> but it did not specifically mention waiver of the right to challenge patent validity. The settlement agreement was accompanied by a license agreement that licensed the patent at issue. After Baseload failed to secure financing to pay the license fee, it filed a

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declaratory judgment action, seeking to invalidate the subject patent. The patentee, Roberts, asserted that the release should bar Baseload's claim of invalidity under *Flex-Foot*, because the release was in the context of a settlement agreement. The district court agreed with the patentee because Baseload's patent claims fell into the category of claims covered by the release.<sup>49</sup>

On appeal, Baseload argued that the settlement agreement was inadequate to release its patent invalidity claims "because the prior litigation between the parties did not involve patent invalidity issues or actual litigation on those issues."<sup>50</sup> The Federal Circuit rejected this argument, and explained: "while the absence of a prior dispute and litigation as to invalidity is pertinent, we do not think that a settlement agreement is ineffective to release invalidity claims unless the exact circumstances described in *Flex-Foot* are present. Each case must be examined on its own facts in light of the agreement between the parties. In the context of settlement agreements, as with consent decrees, clear and unambiguous language barring the right to challenge patent validity in future infringement actions is sufficient, *even if invalidity claims had not been previously at issue and had not been actually litigated.*"<sup>51</sup> Nonetheless, the Federal Circuit reversed, stating that "the clear and unambiguous language necessary to effect a release of patent invalidity defenses is not present" in the settlement agreement.<sup>52</sup>

After *Baseload*, it seems well-settled that, at least under Federal Circuit law, no-challenge clauses are enforced if they are in the settlement agreement that ended a prior litigation. As for "settlement" agreements that settle a private dispute that did not involve a prior litigation, the courts are split. Read broadly, the Federal Circuit's statement in *Baseload* can be interpreted to allow enforcement of no-challenge clauses in license agreements that settled disputes, even if those disputes did not result in the filing of a complaint. The courts adopting this broader view of *Baseload* went on to devise a four-factor test for determining whether the no-challenge clause can be enforced based on the Federal Circuit's analysis in *Baseload*: "(1) the existence and extent of prior litigation between the parties, including whether validity was challenged in the prior litigation; (2) whether there was an opportunity to take discovery; (3) whether the agreement waiving the invalidity defense settled the litigation; and (4) whether

there is clear and unambiguous language waiving the invalidity claim."<sup>53</sup>

On the other hand, the district courts that declined to enforce no-challenge clauses emphasized that the Federal Circuit's statement in *Baseload* is dicta.<sup>54</sup> These courts followed the rationale of *Rates* and focused on the fact that "the Federal Circuit did not actually reach or decide the issue of whether a pre-litigation no-challenge provision is enforceable." Because the Federal Circuit's statement regarding the enforceability of a no-challenge clause where "*invalidity claims had not been previously at issue and had not been actually litigated*"<sup>55</sup> is in dicta, the courts reasoned that it "should not be understood as an endorsement of a pre-litigation settlement exception to *Lear*. Since pre-litigation settlements are not as certain to have preserved judicial resources as settlements that end pending litigation, they do not trigger the conditions that justify the exception."<sup>56</sup>

These courts followed the rationale of the Second and Ninth Circuits in *Rates* and *MSM* "permitting the possibility that pre-litigation settlements can include enforceable no-challenge clauses [which] would encourage patent holders to couch 'license agreements' as 'settlement agreements,' thereby undermining *Lear*'s concern with protecting the ability of licensees to challenge patent validity. As those courts have said, such an exception would swallow the rule."<sup>57</sup>

Other courts avoid applying any Federal Circuit precedent altogether, stating that "the interpretation of contract, i.e., breach of the settlement agreement, is not a federal question."<sup>58</sup>

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*Editor's note:* The conclusion of this article will be published in the next issue of the *Intellectual Property & Technology Law Journal*.

## Notes

1. *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).
2. *Lear*, 395 U.S. at 655.
3. *Lear*, 395 U.S. at 657.
4. *Lear, Inc. v. Adkins*, 395 U.S. 653, 660 (1969).
5. See *id.* at 660.
6. *Id.* (quoting *Adkins v. Lear, Inc.*, 435 P.2d 321, 325-26 (Cal. 1967)).
7. *Id.* at 670-71.



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8. See e.g., *Rates Tech., Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 168 (2d Cir. 2012) (quotation omitted).
  9. *Massillon–Cleveland–Akron Sign Co. v. Golden State Advertising Co.*, 444 F.2d 425 (9th Cir. 1971), cert. denied, 404 U.S. 873 (1971).
  10. *Rates Tech., Inc. v. Speakeasy, Inc.*, 685 F.3d 163 (2d Cir. 2012).
  11. *Rates Tech., Inc. v. Speakeasy, Inc.*, 437 Fed. Appx. 940, 941 (Fed.Cir.2011).
  12. *Rates Tech.*, 685 F.3d at 172.
  13. *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1358 (Fed. Cir. 2010).
  14. *Baseload Energy*, 619 F.3d at 1363; see *infra* Section III.
  15. *Rates Tech.*, 685 F.3d at 173.
  16. *Rates Tech.*, 685 F.3d at 171.
  17. *Rates Tech.*, 685 F.3d at 171.
  18. *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348 (Fed.Cir.1988).
  19. *Hemstreet*, 851 F.2d at 349.
  20. *Hemstreet*, 851 F.2d at 349.
  21. *Hemstreet v. Burroughs Corp.*, 666 F. Supp. 1096 (N.D. Ill. 1987), adhered to on reconsideration, No. 81 C 6412, 1987 WL 13994 (N.D. Ill. July 10, 1987).
  22. *Hemstreet*, 851 F.2d at 349–50.
  23. *Hemstreet*, 851 F.2d at 350.
  24. *Hemstreet*, 851 F.2d at 350.
  25. *Hemstreet*, 851 F.2d at 350.
  26. *Foster v. Hallco Mfg. Co.*, 947 F.2d 469 (Fed.Cir.1991).
  27. *Foster*, 947 F.2d at 472.
  28. See *Foster*, 947 F.2d at 472.
  29. See *Foster*, 947 F.2d at 473.
  30. See *Foster*, 947 F.2d at 472.
  31. See *Foster*, 947 F.2d at 476.
  32. *Foster*, 947 F.2d at 477.
  33. *Foster*, 947 F.2d at 477.
  34. See *Foster*, 947 F.2d at 481–82.
  35. *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362 (Fed. Cir. 2001).
  36. *Flex-Foot*, 238 F.3d at 1363.
  37. *Flex-Foot*, 238 F.3d at 1363.
  38. *Flex-Foot*, 238 F.3d at 1363.
  39. *Flex-Foot*, 238 F.3d at 1364.
  40. *Flex-Foot*, 238 F.3d at 1364.
  41. *Flex-Foot*, 238 F.3d at 1368.
  42. *Flex-Foot*, 238 F.3d at 1368.
  43. *Flex-Foot*, 238 F.3d at 1368.
  44. *Flex-Foot*, 238 F.3d at 1370.
  45. *Flex-Foot*, 238 F.3d at 1370.
  46. *Flex-Foot*, 238 F.3d at 1370.
  47. *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1358 (Fed. Cir. 2010).
  48. *Baseload Energy*, 619 F.3d at 1359.
  49. See *Baseload Energy, Inc. v. Roberts*, 654 F. Supp. 2d 21, 26 (D.D.C. 2009), rev'd and remanded, 619 F.3d 1357 (Fed. Cir. 2010).
  50. *Baseload Energy*, 619 F.3d at 1363.
  51. *Baseload Energy*, 619 F.3d at 1363 (emphasis added).
  52. *Baseload Energy*, 619 F.3d at 1364.
  53. *TMI Prod., Inc. v. Rosen Elecs., L.P.*, CV-12-02263–RGK–SPX, 2013 WL 12114078, at \*5 (C.D. Cal. Nov. 27, 2013); see also, *Kee Action Sports, LLC, v. Shyang Huei Indus. Co., Ltd.*, 2015 WL 9581808, at \*6 (D. Or. Dec. 30, 2015) (“Baseload make[s] clear that no-challenge clauses can be enforceable under Federal Circuit law, depending on the facts of each case.”).
  54. *Ford Motor Co. v. Versata Software, Inc.*, 2016 WL 6650380, at \*4 n.1 (E.D. Mich. Nov. 10, 2016); see also *Rates Tech.*, 685 F.3d at 174; *Ocean Tomo, LLC v. PatentRatings, LLC*, 262 F. Supp. 3d 553, 565 (N.D. Ill. 2017) (“Baseload’s dicta should not be understood as an endorsement of a pre-litigation settlement exception to Lear.”).
  55. *Baseload Energy*, 619 F.3d at 1363.
  56. *Ocean Tomo, LLC v. PatentRatings, LLC*, 262 F. Supp. 3d 553, 565 (N.D. Ill. 2017).
  57. *Ocean Tomo*, 262 F. Supp. 3d at 565.
  58. *Peregrine Network Inc. v. Glob. Commc’ns Servs. Inc.*, No. CV-10-2653–PHX–JAT, 2011 WL 114500, at \*2 (D. Ariz. Jan. 12, 2011).

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## From License to Restraint: Challenging the No-Challenge Clause in Patent Licenses—Part II

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Though no-challenge clauses are common, their enforceability is still subject to debate. Not only will these clauses need to be interpreted in any dispute on enforceability, but also the outcome may differ depending on factors extrinsic to the four corners of the agreement, e.g., choice of law, whether the license is a post-litigation settlement agreement, and whether the case includes patent infringement claims. This two-part article examines those factors based on the Supreme Court's and the circuit courts' caselaw.

The first part of this article, published in the October 2023 issue of the *Intellectual Property & Technology Law Journal*, discussed *Lear v. Adkins* and its expansion, and circumstances under which a

no-challenge clause is enforceable. This second part explores the Patent Trial and Appeal Board's disregard of no-challenge clauses, the federal courts' response, and the governing law. It concludes that, given the state of the law, it remains to be seen whether a no-challenge clause in a pre-litigation "settlement agreement" is enforceable.

### PTAB'S Disregard of No-Challenge Clauses and the Federal Courts' Response

Another venue available for a licensee to challenge the validity of a patent is through inter-partes review (IPR) or post-grant review (PGR) proceedings at the Patent Trial and Appeal Board (PTAB). The PTAB has shown a strong preference to ignore any no-challenge clause that may, on its face, prohibit the petitioner from challenging the validity of the patent subject to the petition. For example, in *Dot Hill Sys. Corp. v. Crossroads Sys., Inc.*,<sup>1</sup> the PTAB considered the enforceability of a no-challenge clause in the context of a petition for inter-partes review.

*Dot Hills* involved a settlement agreement with a no-challenge clause, so it would have been enforceable under the Federal Circuit's *Flex-Foot* and *Baseload* precedence. The patent owner,

The authors, attorneys with O'Melveny & Myers LLP, may be contacted at [jkappos@omm.com](mailto:jkappos@omm.com) and [bmoon@omm.com](mailto:bmoon@omm.com), respectively.

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Crossroad, and the licensee, Dot Hill, were engaged in a patent-infringement lawsuit filed in 2003.<sup>2</sup> The parties settled in 2006 with a written agreement. Shortly afterward, Crossroads filed a second lawsuit in the same court, alleging breach of the settlement agreement, which again ended with the parties entering into an amended settlement agreement. The amended agreement unambiguously provided that “Dot Hill agrees that it will not challenge, participate in any challenge to, or aid any Third Party in challenging the validity or enforceability of any patent in the ’972 Patent Family [defined to expressly include the patent at issue].”<sup>3</sup>

In 2013 the relationship between Crossroads and Dot Hill deteriorated, resulting in a royalty dispute and litigation concerning Dot Hill’s alleged infringement of the Crossroads’ patents at issue.<sup>4</sup> In response, Dot Hill petitioned the PTAB to initiate an inter partes review (IPR) of patents licensed under the agreement. Crossroads filed a preliminary response to Dot Hill’s petition, arguing that Dot Hill was contractually estopped from challenging the validity of the patents pursuant to the “no challenge” clause.<sup>5</sup> Dot Hill replied to Crossroads’ preliminary response, arguing that if the US Congress intended the PTAB to consider contractual estoppel, 35 U.S.C. § 311 (providing for limitations on the PTAB’s jurisdiction to hear patent reviews) would have been worded differently.<sup>6</sup>

The PTAB accepted Dot Hill’s argument and instituted an IPR proceeding. In its institution decision, the PTAB referred to cases finding that no explicit statutory provision provides for affirmative estoppel-based defenses—such as assignor estoppel—precluding institution of an inter partes review. The PTAB explained that “the statutory analyses of those cases also are applicable to contractual estoppel.”<sup>7</sup> The PTAB further noted that “if [the PTAB] do[es] not institute review in this proceeding . . . Petitioner would be prejudiced because it would lose its opportunity to challenge the claims of the [subject] patent before the [PTAB].”<sup>8</sup>

Given that the decision to institute is non-reviewable,<sup>9</sup> it is reasonable to assume that a no-challenge clause will not derail the IPR proceedings. Notably, in *Dot Hill*, the PTAB could have declined to apply the no-challenge clause on alternate grounds—i.e., that the no-challenge clause was no longer in effect because the license agreement itself was terminated

due to the loyalty dispute.<sup>10</sup> Yet, the PTAB chose to state its opinion that the statutory language providing for the IPR proceedings does not allow the PTAB to deny institution based on private contracts. The fact that the PTAB also did not try to interpret the no-challenge clause itself seems to indicate that the actual language of the no-challenge clause—including whether the clause is clear and unambiguous, or whether the clause contemplates the PTAB proceedings—would not have made any difference to the outcome.

Nonetheless, a patentee may still collaterally attack the prosecution of such proceedings—for example by seeking an injunction in a court to prohibit the licensee from pursuing (or continuing) with its challenge in the PTAB. At least in the context of forum-selection clauses, the Federal Circuit appears to be receptive to the idea that a patentee can contractually prohibit a licensee from challenging the subject patent via IPR.

In *Dodocase VR, Inc. v. MerchSource, LLC*,<sup>11</sup> the Federal Circuit upheld a district court’s grant of a preliminary injunction ordering a patent challenger to withdraw its IPR petition. In *Dodocase*, the plaintiff-patentee, Dodocase, entered into a pre-litigation license agreement with MerchSource. The agreement included a provision prohibiting MerchSource from challenging the validity or enforceability of the licensed intellectual property, as well as a forum-selection clause which specified that “any disputes arising from the agreement would be governed by the laws of the State of California and [be] litigated in the courts located in San Francisco County or Orange County, California.”<sup>12</sup> Later, in 2017, MerchSource informed Dodocase that it would no longer pay royalties under the license, because the relevant patents were invalid. After negotiations between the parties broke down, Dodocase filed a complaint in the Northern District of California, seeking an injunction to prevent MerchSource from breaching the license agreement and infringing on the patents.<sup>13</sup> After Dodocase filed the district court case, MerchSource filed three separate PTAB Petitions challenging each of the three asserted patents. Dodocase then filed a motion for a preliminary injunction, requesting the district court to order MerchSource to withdraw the PTAB Petitions, arguing that they were filed in violation of the “no-challenge” and “forum selection” clauses in the license agreement.<sup>14</sup>



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The district court considered both clauses in turn. It found that the no-challenge clause does not prevent MerchSource from challenging the validity of the patents under *Lear* and its progeny.<sup>15</sup> But, as for the forum selection clause, the court distinguished *Lear*, stating that “*Lear* did not consider a request for injunctive relief on the basis of an alleged breach of a forum selection clause.”<sup>16</sup> The district court found that “the PTAB proceedings challenging the validity of the licensed patents after [Dodocase] sought to enforce the license in [the district court] fall within the scope of the forum selection clause as they ‘aris[e] out of or under’ the terms and performance of the contract.”<sup>17</sup> Affirming the decision, the Federal Circuit explained that, applying California law, the forum selection clause at issue—which used the language “arising out of or under this Agreement”—encompassed PTAB proceedings.<sup>18</sup> The Federal Circuit also noted that, in analyzing the public interest, the district court properly considered “the public interest in enforcing contractual rights and obligations,” “the fact that MerchSource would be able to challenge the validity of the patents in the district court,” and that “independent third parties could initiate separate PTAB proceedings.”<sup>19</sup>

Though the Federal Circuit did not explicitly refer to *Lear*, its analysis that the public interest may be satisfied because “independent third parties could initiate separate PTAB proceedings” runs counter to *Lear*’s stated rationale for abrogating licensee estoppel—that “Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor’s discovery.”<sup>20</sup> It is also notable that the Federal Circuit explicitly declined to address the effect of a no-challenge clause under *Lear*.<sup>21</sup> As a result, *Dodocase* does not resolve the issue of whether the no-challenge clause may also prohibit a licensee from mounting invalidity attacks in district court.

It is also unclear whether the forum selection clause would be applicable to validity challenges that are filed in the PTAB before the filing of any district court case seeking to enforce the subject license. In *Dodocase*, the Federal Circuit resolved the issue before the PTAB issued its final written decisions.<sup>22</sup> But if a speedier patent licensee were to obtain a PTAB decision canceling a patent subject to a similar license agreement with a forum selection clause before a district court litigation contesting

the enforceability of the forum selection clause is concluded, the Federal Circuit may have reached a different conclusion from *Dodocase*.<sup>23</sup> Nonetheless, *Dodocase* provides at least some protection for patentees who wish to keep validity challenges out of the PTAB.

## Governing Law

It is common practice to include a choice-of-law provision designating the governing law to be applied in disputes arising from an agreement. The general expectation is that the chosen law would be applied to determine the enforceability of all provisions in the agreement.<sup>24</sup> But when it comes to interpreting a patent license—such as a no-challenge clause—in a patent license agreement, the application of governing law is far from straightforward. This lack of clarity occurs because, when the patent license agreement is allegedly breached, the licensor-patentee would often sue the licensee for breach of license as well as for patent infringement. The appeals would be taken to the Federal Circuit, where the Federal Circuit may apply its own federal common law.

For example, in *Flex-Foot, Inc. v. CRP, Inc.*<sup>25</sup> the Federal Circuit’s ruling was governed by its own precedent: “the question of whether a settlement agreement bars a party from challenging the validity of a patent in a subsequent action is intertwined with the substance of enforcement or a patent right.” The approach continued in *Baseload Energy, Inc. v. Roberts*,<sup>26</sup> where the Federal Circuit extended the same reasoning to the settlement agreement, stating that “the question of whether a settlement agreement bars a party from challenging the validity of a patent in a subsequent action is intertwined with the substance of enforcement of a patent right. Therefore, [the Federal Circuit] will apply [its own] law to these issues.”<sup>27</sup> In *Cheetah Omni LLC v. AT&T Servs., Inc.*,<sup>28</sup> the Federal Circuit interpreted a patent license agreement with Texas law as governing. Despite the presence of the choice-of-law provision, the Federal Circuit nonetheless applied a federal common law under its own precedents to find that an express license to a patent includes an implied license to its continuations, with no reference to Texas law.<sup>29</sup>

On the other hand, in *Rates Technology, Inc. v. Speakeasy, Inc.*,<sup>30</sup> the Federal Circuit declined to exercise appellate jurisdiction over a case where

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a no-challenge provision of a patent license agreement was enforceable because a “contract dispute does not require the resolution of a related question of patent law, such as inventorship, infringement, validity, or unenforceability.”<sup>31</sup> The Federal Circuit transferred the case to the Second Circuit, which explicitly declined to apply Federal Circuit precedents and set forth its own interpretation of the Supreme Court’s decision in *Lear v. Adkins*.<sup>32</sup>

As one district court examining these cases noted, the difference in outcome may be “understood by highlighting the different types of claims at issue: *Rates* involved breach of contract claims but not patent infringement claims, while *Flex-Foot* and *Baseload* involved patent infringement claims but not breach of contract claims.”<sup>33</sup> Yet, this distinction places the power to apply or ignore the choice of law provisions into the hands of the lawyers drafting the complaint. A clever lawyer drafting a complaint based on the breach of patent license agreement can draft a complaint to leave out or include a patent infringement claim, with a view toward a favorable precedent in a given circuit. The potential to manipulate appellate jurisdiction to apply a different body of precedent may result in differing outcomes.

## Conclusion and Remaining Questions

The Federal Circuit itself has not had occasion to determine whether a no-challenge clause in a license agreement that did not involve any prior litigation can still be considered a “settlement agreement,” which would trigger the rationale of *Flex-Foot* and *Baseload*. Nonetheless, even where the agreement did not resolve any formal litigation, at least some of the distinctions over *Lear* made in *Flex-Foot* and *Baseload*—that the license agreement in *Lear* “did not contain, and was not accompanied by, any promise by the licensee not to challenge the validity of the patent”<sup>34</sup>—would still apply. Also, to the extent the patentee can characterize the negotiation process as a dispute that could have resulted in litigation and the resulting license agreement as a settlement agreement, an argument can be made that the enforcement of the no-challenge clause in the license agreement furthers the “public policy totally absent in *Lear*: the encouragement of settlement of litigation and the need to enforce such

settlements in order to encourage the parties to enter into them.”<sup>35</sup>

Given the state of the law, it remains to be seen whether a no-challenge clause in a pre-litigation “settlement agreement” is enforceable. *Baseload* left this question open because the Federal Circuit found the agreement in question to be not sufficiently “clear and unambiguous.”<sup>36</sup> It seems, though, that a patent challenger trying to avoid the enforcement of the no-challenge clause in their licenses could pursue validity challenges in the PTAB—while trying to avoid collateral attacks on the PTAB proceedings by delaying the resolution of the enforcement of a no-challenge clause until after the PTAB invalidates the patents. A patentee trying to enforce the no-challenge clause may, on the other hand, try to characterize the negotiation of the license agreement as a “settlement,” and attempt to avoid the application of the Ninth or Second Circuit’s jurisdiction. Including patent infringement claims in the complaint, along with breach of the contract claims, may further their chances to invoke the Federal Circuit’s case law. Licensors are strongly advised to incorporate these various approaches, either individually or in combination, into their patent licensing agreements to minimize the risk of future challenges by licensees.

## Notes

1. Dot Hill Sys. Corp. v. Crossroads Sys., Inc., IPR2015-00822, Paper 18 at 7–8 (PTAB Sept. 17, 2015). (Footnote and section numbering continues from the first part of this article.)
2. Crossroads Sys. (Texas), Inc. v. Dot Hill Sys. Corp., No. 1:03-cv-754-SS (W.D. Tex., filed Oct. 17, 2003).
3. Dot Hill Sys. Corp. v. Crossroads Sys., Inc., IPR2015-00822, Patent Owner’s Preliminary Response to Petition at 3 (PTAB June 18, 2015).
4. Crossroads Sys. (Texas), Inc. v. Dot Hill Sys. Corp., No. 1:03-cv-800-SS (W.D. Tex., filed Sept. 11, 2013).
5. Dot Hill Sys. Corp. v. Crossroads Sys., Inc., IPR2015-00822, Patent Owner’s Preliminary Response to Petition at 2–6 (PTAB June 18, 2015).
6. Dot Hill Sys. Corp. v. Crossroads Sys., Inc., IPR2015-00822, Petitioner’s Reply to Patent Owner’s Preliminary Response at 2–4 (PTAB July 17, 2015).
7. Dot Hill Sys. Corp. v. Crossroads Sys., Inc., IPR2015-00822, Paper 18 at 8 (PTAB Sept. 17, 2015) (citing *Esselte Corp. v. Dymo*, IPR2015-00779, Paper 13 at 4–7 (PTAB Aug. 28, 2015) (determining that 35 U.S.C.

- §§ 311, 314–316 do not provide assignor estoppel as a defense to inter partes review and rejecting Patent Owner’s contractual bar argument for the same reasons given for its assignor estoppel arguments).
8. Dot Hill Sys. Corp. v. Crossroads Sys., Inc., IPR2015-00822, Paper 18 at 9 (PTAB Sept. 17, 2015).
  9. 35 U.S.C. § 314(d) (“No Appeal.—The determination by the Director whether to institute an inter partes review under this section shall be final and nonappealable.”); *Thryv, Inc. v. Click-To-Call Techs., LP*, 140 S. Ct. 1367, 1373 (2020) (“a contention that the agency should have refused ‘to institute an inter partes review’” is, even when raised on grounds other than the reasonable likelihood of prevailing, still subject § 314(d)’s bar).
  10. See *Dot Hill Sys. Corp. v. Crossroads Sys., Inc.*, IPR2015-00822, Petitioner’s Reply to Patent Owner’s Preliminary Response at 4–5 (PTAB July 17, 2015).
  11. *Dodocase VR, Inc. v. MerchSource, LLC*, 767 F. App’x 930, 935 (Fed. Cir. 2019).
  12. *Dodocase*, 767 F. App’x at 932.
  13. *Dodocase*, 767 F. App’x at 932.
  14. *Dodocase*, 767 F. App’x at 932.
  15. *Dodocase VR, Inc. v. MerchSource, LLC*, No. 17-CV-07088-EDL, 2018 WL 1475289, at \*5 (N.D. Cal. Mar. 26, 2018).
  16. *Dodocase*, 2018 WL 1475289, at \*5.
  17. *Dodocase*, 2018 WL 1475289, at \*7.
  18. *Dodocase*, 767 F. App’x at 935.
  19. *Dodocase*, 767 F. App’x at 935–36.
  20. *Lear, Inc. v. Adkins*, 395 U.S. 653, 670 (1969).
  21. The district court for the Northern District of California rejected the patentee’s argument based on no-challenge clause to enjoin the licensee to withdraw its IPR petition, but granted injunction based on the forum selection clause. See *Dodocase VR, Inc. v. MerchSource, LLC*, No. 17-CV-07088-EDL, 2018 WL 1475289, at \*4–5 (N.D. Cal. Mar. 26, 2018). The Federal Circuit did not review the no-challenge clause portion of the district court’s findings. *Dodocase VR, Inc. v. MerchSource, LLC*, 767 F. App’x 930, 933 n.2 (Fed. Cir. 2019) (“The district court rejected Dodocase’s argument that it was likely to prevail on the merits of its claim that MerchSource also breached the no-challenge clause, but that is not at issue in this appeal.”).
  22. See *Dodocase VR, Inc. v. MerchSource, LLC*, 767 F. App’x 930, 933 (Fed. Cir. 2019) (noting while the district court’s preliminary injunction was stayed pending appeal, the PTAB proceedings were allowed to continue, and the PTAB is expected to issue its final written decisions in August 2019, four months after the Federal Circuit’s opinion issued).
  23. For example, the licensee may be able to argue that, because the PTAB already issued the final written decision, the Federal Circuit lacks jurisdiction to review the grant of preliminary injunction which became moot.
  24. See e.g., *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 262 (1979) (“Commercial agreements traditionally are the domain of state law. State law is not displaced merely because the contract relates to intellectual property which may or may not be patentable; the states are free to regulate the use of such intellectual property in any manner not inconsistent with federal law.”).
  25. *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362 (Fed. Cir. 2001).
  26. *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357 (Fed. Cir. 2010).
  27. *Baseload Energy, Inc. v. Roberts*, 619 F.3d 1357, 1361 (Fed. Cir. 2010) (citing *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1365 (Fed. Cir. 2001)).
  28. *Cheetah Omni LLC v. AT&T Servs., Inc.*, 949 F.3d 691 (Fed. Cir. 2020).
  29. *Cheetah Omni LLC v. AT&T Servs., Inc.*, 949 F.3d 691, 695–696 (Fed. Cir. 2020).
  30. *Rates Tech., Inc. v. Speakeasy, Inc.*, 437 F. App’x 940 (Fed. Cir. 2011).
  31. *Rates Tech., Inc. v. Speakeasy, Inc.*, 437 F. App’x 940, 941 (Fed. Cir. 2011) (citing *Lab. Corp. of America Holdings v. Metabolite Labs., Inc.*, 599 F.3d 1277, 1283–84 (Fed. Cir. 2010)).
  32. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 173–74 (2d Cir. 2012) (the Second Circuit “is not bound by the holdings – much less the dicta – of other federal courts of appeal.”).
  33. *Transocean Offshore Deepwater Drilling Inc. v. Noble Corp. Plc*, 451 F. Supp. 3d 690, 696 (S.D. Tex. 2020).
  34. *Flex-Foot*, 238 F.3d at 1368.
  35. *Hemstreet*, 851 F.2d at 350.
  36. *Baseload Energy*, 619 F.3d at 1364.

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