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Sovereign immunity growing as inter partes defense, effect on licensing terms unclear

The University of Florida's successful use of sovereign immunity to end an *inter partes* challenge was no fluke, as two other schools are using the same defense and legal analysts say it will become a reliable strategy for some universities. The security offered by having that defense available could lead those universities to be more bullish with their royalty rates and IP terms, but that does not appear to be happening just yet, experts say.

The interest in sovereign immunity took off when the Patent Trial and Appeal Board (PTAB) accepted it in *Covidien LP v. University of Florida Research Foundation Inc.* [IPR2016-01274, -01275, -01276], dismissing three petitions challenging the claims of a patent owned by the UFRF. The foundation is an arm of the State of Florida by way of the University of Florida, the PTAB noted, so the foundation is entitled to a sovereign immunity defense for an *inter partes* review (IPR) of the challenged patent.

More recently the PTAB dismissed an IPR for the second time based on an assertion of 11th Amendment sovereign immunity made by the University Maryland in Baltimore. This is a significant confirmation of the validity of the sovereign immunity defense, says **Stephen J. Gardner, JD**, partner with the law firm of Quarles and Brady in Madison, WI.

The latest decision came in the case of *NeoChord, Inc. v. Univ. of Md., Baltimore* [Case No. IPR2016-00208, Paper 28 (PTAB, May 23, 2017)], in which the PTAB dismissed NeoChord's IPR proceeding based on the sovereign immunity defense.

In the UMB case, the petitioner NeoChord asserted that a patent directed to cardiac valve repair and owned by UMB was unpatentable. In its decision ultimately dismissing the case, the PTAB largely followed the same rationale as the UFRF

opinion, though the PTAB panel went out of its way to note that the UFRF decision was not binding precedent, Gardner notes.

The PTAB found that UMB was an arm of the State of Maryland, and that IPRs are adversarial, contested proceedings appropriate for an assertion of sovereign immunity. NeoChord's argument that UMB's voluntary participation in a briefing in the case amounted to a waiver of sovereign immunity by conduct was found unpersuasive by the board. The PTAB noted that UMB had not "delayed for any tactical reasons," and thus the PTAB followed precedent holding that "mere participation in judicial proceedings does not create a waiver unless the State has taken affirmative steps to invoke federal jurisdiction."

The UMB case could take another turn, however. Because the UMB decision was issued after the IPR had been instituted, the chances of an appeal and eventual precedential ruling by the Federal Circuit are significantly greater than was the case with the UFRF proceeding, Gardner says.

A big win for state schools

The decision strengthens the growing perception that patents owned by governmental entities like public universities and research hospitals are less susceptible to invalidity challenges, Gardner says. TTOs at state universities will benefit in several ways, he says. Improved negotiating power for royalty rates is one likely result.

Patents that can be shown to less susceptible to challenge can command higher royalty rates, and license agreements commonly have a royalty escalation clause that increases the royalty rate in the event the licensed patent survives a validity challenge, Gardner notes. If sovereign immunity can be used by public universities to avoid IPR challenges,

Gardner says it follows that they can charge more for those licenses.

In addition, public universities and their licensees may soon start seeing fewer IPR challenges as a result of these rulings, so they also could benefit from lower litigation costs, he says. Research sponsors also may stop demanding full ownership of patents resulting from sponsored research and clinical studies, opting for joint ownership to try to benefit from the university's sovereign immunity. Though the theory has not been tested yet, Gardner says it is possible that the sovereign immunity would extend to all of the joint owners of a patent.

Shared immunity not certain

That is unlikely, says **Dan Venglarik**, JD, partner in the technology/intellectual property law group at the law firm of Munck Wilson Mandala in Dallas, TX. The defense only applies to the university when a jointly owned patent is challenged, he says, and frequently it is the exclusive licensee of a university patent that brings an infringement action that prompts the filing of an IPR.

If a private venture is a co-owner of the patent, based on having funded the research, Venglarik says it will not be entitled to sovereign immunity.

"The university could join the IPR proceeding or not, but it is unlikely that the state's sovereign immunity extends to the co-owner. That is a personal privilege, not one that attaches to the property," Venglarik says. "For similar reasons, sovereign immunity will likely not extend to cover exclusive licensees. That issue was present in NeoChord, but did not get raised or briefed because the University of Maryland waited until oral argument to raise the sovereign immunity defense."

Perhaps the most interesting distinction between the Florida and Maryland decisions is the issue of whether the defense of sovereign immunity is waived by participating in the IPR proceeding, says **Christopher M. Humphrey**, JD, a patent attorney with the Womble Carlyle law firm in Raleigh, NC.

In the Florida case, the university raised the sovereign immunity issue very early in the process, before the deadline for the patent owner to respond to the IPR petition and thus before the IPR petition was ruled upon by the Board. In other words, the issue was raised before the USPTO ruled on whether to even institute the IPR proceeding. In the

Maryland case, Humphrey notes, the IPR proceeding was in a very advanced stage.

The oral hearing had already occurred, which is typically the last step before the final written decision is handed down. NeoChord, the petitioner in the Maryland IPR, raised this issue and argued that the university waived its defense by its participation in the proceeding to such an advanced stage. The PTAB disagreed, noting that the Supreme Court has stated that the Eleventh Amendment defense can be raised at any time.

However, the PTAB did hedge on this point a bit by attempting to distinguish another case in Maryland where the U.S. Court of Appeals for the Ninth Circuit held that failing to raise the immunity defense until the first day of trial constituted waiver, Humphrey explains. The PTAB noted that the Ninth Circuit case (*Hill v. Blind Industries and Services of Maryland* [179 F.3d 754 (9th Cir. 1999)]) appeared to follow precedent suggesting that the law of waiver can vary from state to state, meaning the law of some states provides for waiver of the sovereign immunity defense if the state entity participates in the legal proceeding.

"The Board concluded that the law of Maryland does not appear to provide for such a waiver. This at least leaves open the possibility of arguing that a university has waived its defense by participating in an IPR before raising the defense," Humphrey says. "It would be prudent for any university considering use of the defense to raise it at the earliest opportunity, which would be before even making the initial substantive response to an IPR petition, as in the case of the University of Florida."

On the other hand, Gardner sees an immediate lesson for public universities already involved in an IPR. Since it worked for the University of Maryland, he says they should try for sovereign immunity no matter how far along they are.

"What this says to any university deep in an IPR right now is that you should hit the brakes and file a motion to dismiss. I think those are going to start coming in waves," Gardner says. "We're probably also going to see more settlements as the petitioners consider that possibility."

Minnesota case raises new questions

In the third and most recent 11th Amendment case, the PTAB recently granted the University of Minnesota's request to file a motion to dismiss an

IPR on sovereign immunity grounds. That case is being watched closely because it could answer some lingering questions about the sovereign immunity defense, says **Peter A. Sullivan**, JD, partner with the law firm of Foley Hoag in New York City.

“There is a parallel lawsuit that has the university in it and the question becomes whether filing a lawsuit against the same parties is going to be deemed a waiver for immunity purposes in the PTAB,” he explains. “Until we have the answer from the Minnesota case, we won’t know whether public universities will be completely protected from PTAB. If they are, that might be a leverage point that allows them to be more aggressive with royalties, but I think universities are still waiting to see if you can have filed a suit and still claim sovereign immunity.”

There also is the possibility that the PTAB decisions could be reversed on appeal, Sullivan says.

“This will have to get dealt with at the appellate level before we have some firm answers. Just because someone at PTAB says it, that doesn’t mean it’s going to hold up if someone decides to appeal,” Sullivan says. “People are encouraged by the fact that PTAB has seen this as a viable defense, but the question is whether this gets moved up the chain and ratified by the federal circuit.”

Contract law may still be an issue for universities using the sovereign immunity defense, notes **Jeffrey R. Stone**, JD, partner with the law firm of Barnes & Thornburg in Minneapolis, MN.

“They can still address the validity issue through basic contract law. That would be a response to the breach of contract claim, basically saying the contract itself and the goods within are so altered now that the purpose of the contract is frustrated,” Stone says. “The goods of the contract are the claims of the patent and over time the goods have changed significantly. Covidien would argue that it contracted for claims that would have allowed it operate in the marketplace without infringement risk, and over time the applicable laws have been interpreted such that these claims are no longer the same in terms of validity and scope that they were when we contracted for them.”

If the Minnesota case determines that universities can file lawsuits without losing their immunity, that could be a game changer, says **Doug Stewart**, JD, partner with the Bracewell law firm in Washington, DC.

“If they can both affirmatively assert patents for monetization purposes and avoid the risk of IPR

challenges, that’s a pretty significant advantage given the role IPR challenges have come to play recently in patent valuations,” Stewart says. “That could encourage more litigation activity by universities, given that patents not only are not going to be subject to the same types of challenges but they also can more accurately assess the risks and costs. They won’t have to factor in the possibility of an IPR, which can cost anywhere from \$250,000 to much, much more than that.”

Limitations to sovereign immunity

The benefits of sovereign immunity extend only to state schools, Venglarik notes. Private universities -- including some of the most prolific innovators in the country such as MIT, Stanford, and Johns Hopkins -- do not enjoy the same benefit of sovereign immunity. It also does not apply to foreign universities.

Another important distinction is how patents are held by foundations, Venglarik says. Some state schools hold patents in an entity separate from the university, such as the Wisconsin Alumni Research Foundation (WARF). While the University of Florida Research Foundation was an actual part of the University of Florida, WARF holds itself out as an independent, nonprofit technology transfer organization serving the University of Wisconsin-Madison, he says. That could change how the PTAB sees a sovereign immunity claim, he adds.

There are still other limitations. For the relatively small number of state universities that can potentially benefit, Venglarik notes that the distinction between immunity from claims for damages and challenges to an alleged property right held by a state has not been fully briefed or adjudicated. Further, the issue of waiver of sovereign immunity by a university in filing an infringement action on the patent being challenged by the IPR -- which is necessary to recover any royalties -- has yet to be decided by the federal circuit or the PTAB.

While there is a favorable decision on declaratory judgment jurisdiction involving the University of Texas, that is a different statutory scheme, Venglarik says. In addition, the existence of a co-owner or an exclusive licensee that might be joined in the IPR could affect the calculus, he says. While the university might have sovereign immunity, the licensee probably will not and the patent would face the same challenge.

Better negotiating position

Gardner says public university TTO leaders may be eager to take advantage of this new selling point for patents, but some finesse will be required.

“I don’t think it’s something you would emphasize in that honeymoon period as a reason for higher royalty rates. You just don’t want to raise the specter of litigation at that point in time,” he says. “But if the licensee is wondering if you’re really going to help police the patent and protect their investment, this can be used to assure them that the likelihood of a successful challenge is very low. I’ve seen that already in a couple different negotiations, and the savvy investors like knowing that simply sending a demand letter isn’t going to instantly result in an IPR.”

Licensees may be limited in how much more they can pay for a patent even if it comes with a bulletproof IPR defense, but the sovereign immunity card can help build reliability and take some pressure off the university when it comes to policing the patent, Gardner says.

“Universities don’t always want to seem litigious, but when you can go to a company that is infringing and they know they can’t file an IPR because it would be fruitless to do so, that changes the dynamic tremendously,” Gardner says. “I think that’s where you’re going to see the real benefit to universities, in their ability to support their licensees and protect their patents.”

Venglarik agrees that the availability of the sovereign immunity defense improves state universities’ position in negotiation relative to that of private par-

ties, since validity challenges outside of PTAB proceedings succeed far less often. The advantage is distinct, he says, but probably not overwhelming.

Essentially, state universities are in the same position that they were in prior to the creation of the PTAB in 2012, while everyone else is stuck in the post-AIA world, he says.

The valuation of university-owned patents, at least those without exclusive licensees, is likely to be higher than if the same patent were held by a private party, he observes.

“However, the difference is unlikely to be dramatic, certainly not a thousand-fold higher, so universities will not immediately start to see huge revenue increases. State university TTOs are likely to consider this in their internal patent valuations and licensing decisions, but are unlikely to start making outrageous demands for enormous royalty rates,” Venglarik says. “State universities may be able to ask for slightly higher royalty rates than before the decision, but until issues regarding sovereign immunity as it applies to alleged property rights and as it applies to jointly owned or exclusively licensed patents are worked through by the PTAB and the courts, I doubt that anyone is going to get too excited and start making outrageous demands.”

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