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Delaware High Court Allows Licensee To Stop Royalty Payments By Disclaiming Patent Claims

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In an opinion issued on March 3, 2021, the Supreme Court of Delaware, one of the top commercial courts in the country, overturned a jury verdict that Glaxo Group Limited and Human Genome Sciences, Inc. (collectively, "GSK") breached the implied covenant of good faith and fair dealing when GSK disclaimed all the claims of a lupus treatment patent it had licensed from Biogen thereby extinguishing its obligation to pay ongoing royalties on sales of its lupus treatment drug. The court's reasoning and the outcome raise important considerations for life sciences practitioners in the transactional, litigation, and patent disciplines.

In 2007, Biogen held an issued patent related to a method for treating lupus, and GSK had a pending application directed to substantially the same subject matter. Rather than initiate interference proceedings before the United States Patent and Trademark Office to determine priority under the "first to invent" patent law in place at the time, Biogen and GSK elected to appoint a neutral arbitrator to decide the priority issue. The arbitrator ruled that GSK invented the lupus treatment method before Biogen.

Following the arbitrator's determination, GSK and Biogen entered into a settlement agreement (the "Agreement"), under which GSK continued prosecution of its patent application and Biogen canceled its patent in exchange for a $3.5 million up-front payment, two milestone payments of $1.5 million each, and ongoing royalties tied to GSK's sale of the lupus treatment drug. With regard to royalties, GSK agreed that its "obligation to make the royalty payments . . . will continue on a country-by-country basis until expiration of the last Valid Claim that, but for the license granted herein, would be infringed by the [lupus treatment] Product."

The USPTO issued U.S. Patent No. 8,071,092 to GSK on December 6, 2011.Through 2012, GSK paid Biogen royalties for sales of the lupus drug as required by the Agreement. In 2012, GSK began paying the royalties to DRIT LP, a healthcare investment vehicle that purchased the royalty rights from Biogen.

In 2015, GSK filed a statutory disclaimer with the USPTO, disclaiming the entire remaining term of all claims of the lupus treatment patent. GSK concurrently informed DRIT that it would no longer make royalty payments under the Agreement because the statutory disclaimer eliminated any “Valid Claim” upon which royalties would be payable under the Agreement.

DRIT filed suit in Delaware Superior Court, bringing claims for breaches of contract and the implied covenant of good faith and fair dealing based on GSK’s actions and purported unilateral termination of its obligation to make royalty payments. The Superior Court granted GSK summary judgment of no breach of contract, but permitted the implied covenant claim to proceed to trial. Following trial, the jury returned a verdict that GSK’s statutory disclaimer of the ‘092 patent breached the implied covenant. GSK appealed to the Supreme Court of Delaware.

The Supreme Court of Delaware reversed, opining that the trial court should have granted GSK judgment as a matter of law that it had not breached the implied covenant of good faith and fair dealing. Reviewing Delaware precedent, the court noted that the implied covenant exists to address “gaps” and “to fill in the spaces between the written words” of a contract, but “cannot be invoked ‘when the contract addresses the conduct at issue.’”

Here, the Supreme Court of Delaware focused its analysis on the Agreement’s definition of “Valid Claim”:

[A] claim of an issued, unexpired patent within the Patent Rights that has not expired, lapsed, or been cancelled or abandoned, and that has not been dedicated to the public, disclaimed, or held unenforceable, invalid, or cancelled by a court or administrative agency of competent jurisdiction in an order or decision from which no appeal can be taken or was timely taken, including through opposition, re-examination, reissue or disclaimer.

The court reasoned that because a “Valid Claim” is one that has not been “disclaimed,” and because the Agreement nowhere else expressly prohibited GSK from disclaiming patent claims, there were no gaps in the Agreement and therefore no room to apply the implied covenant. On those grounds, the appeals court reversed the jury, resulting in a win for GSK. In training its focus on the definition of “Valid Claim,” the court de-emphasized the “until expiration” language in the “Royalty Term” provision of the Agreement, which some practitioners may have assumed would be outcome-determinative here—in the opposite direction. The operative “Royalty Term” language provided that royalties would be payable “until expiration of the last Valid Claim that, but for the license granted herein, would be infringed by the Product.”

The opinion may come as a surprise to transactional and licensing specialists, patent practitioners, and litigators alike. Even though the Supreme Court of Delaware noted that the goal of the implied covenant is to “preserve the economic expectations of the parties,” it permitted GSK to cease its royalty obligations through unilateral actions taken after the parties entered into the Agreement.

This case highlights the importance of considering future contingencies and party actions during the negotiation of a licensing arrangement involving future royalties. Had the Agreement placed express limitations on GSK’s ability to invalidate or disclaim the patent, GSK’s royalty obligations likely would have continued.

Some may argue that the holding of the case should be confined to the unique circumstances and facts of the case—GSK as the licensee had the exclusive right to control all patent prosecution and therefore had the power to control whether the claims of the licensed patent remained valid. Under those circumstances, Biogen could be seen as having empowered GSK to eliminate any valid claims of the patent. Even so, we expect transaction counsel will pay special attention to the “valid claim “ definition and litigators will cite the case to support positions that may previously have been thought commercially and legally untenable.

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