Keywords: technology license; patent misuse; liquidated damages; penalty clause

General: A technology license may limit production and use of self-replicating inventions (such as plants) despite the sale of the initial copy. A liquidated damages clause that does not differentiate between degrees of damage and contract provisions that can result in different degrees of damage may be unenforceable.

Monsanto Co. v. McFarling
70 U.S.P.Q.2d 1481 (Fed. Cir., 2004)
April 9, 2004

I. Facts

Monsanto holds patents to certain genetically modified soybean varieties that are resistant to herbicides ("Roundup ready"). Monsanto sells the patented soybeans only if farmers sign a technology license that, in part, limits the farmers' use of the beans. Specifically, the license specifies that the farmers cannot save soybeans for replanting (or sell or otherwise distribute the soybeans to others for replanting).

McFarling is a farmer who bought the patented soybeans from Monsanto, planted them, and saved seeds from crops from 2 years, replanting them on his farm.

Monsanto sued McFarling for infringement and breach of the technology license. McFarling, defending his actions on numerous grounds, including patent misuse, ultimately lost. Among McFarling's arguments was the issue of whether Monsanto had effectively unfairly extended its patent monopoly by limiting use of the 2nd generation seeds via the technology license. The CAFC reviewed the case and upheld the decision in favor of Monsanto on all counts.

The district court then ruled on damages. The technology license included a liquidated damages clause that applied a 120 times multiplier. According to the clause, a violator of any provision of the agreement would owe 120 times the license fee times the number of bags of seeds purchased. McFarling defended now on the basis of patent misuse (again), alleged violation of antitrust laws (tying), and the unenforceability of the liquidated damages clause. The district court ruled in favor of Monsanto, finding the liquidated damages clause enforceable (under Missouri law) and awarded damages in accordance with the clause.

McFarling appealed.

II. Issues

A. Whether provisions of a technology license that limit the use of subsequent generations of a patented self-replicating product following a sale of the first generation constitute patent misuse or illegal tying?

B. Whether a liquidated damages clause that applies a single formula regardless of the type of product for which a breach occurs or the particular provision breached is enforceable (or unenforceable as a penalty clause)?

III. Discussion

A. No. While the court did not specifically couch this issue as uniquely one of self-replicating products (e.g., plants and seeds), it is unlikely to be susceptible to extrapolation into other contexts.[1] The court reviewed the law of patent misuse and tying, dismissing both in turn.

Regarding patent misuse, the court observed that the policy behind this doctrine is to prevent a patentee from using the patent to obtain market benefit beyond that which inures in the statutory patent right. Citing it own precedent, the court noted that the key inquiry is whether, by imposing conditions that derive their force from the patent, the patentee has impermissibly broadened the scope of the patent grant with anticompetitive effect.

The court separated the rights granted under the patent from those permitted by the technology agreement. Effectively, the court held that the patent covered all generations of soybeans produced. The technology license, on the other hand, did not impose a restriction on the use of the soybeans purchased, but only prohibited use (e.g., replanting, sale, etc.) of the 2nd generation seeds.

Having concluded no patent misuse, the court dismissed the tying argument virtually out-of-hand. That is, if Monsanto's activity is within its rights under the patent, such activities are shielded from antitrust laws by virtue of the patent statute.

B. No. The court applied Missouri law to hold the clause unenforceable. Missouri law requires, for a damages clause to be valid, that (1) the amount fixed for damages be a reasonable forecast for harm caused by a breach, and (2) the harm be of a kind difficult to accurately estimate. Moreover, Missouri, which is not unusual in this respect, applies an "anti-one-size rule" by which various stipulations probably must be made for various degrees and types of breach.

In this case, Monsanto applied a 120 times multiplier for this and for other similar agreements for other seeds (e.g., cotton seeds). The basis for the multiplier was, however, intended to be the rate of replication of the seeds from one year to the next. Because different plants have different rates of replication, the same multiplier should not have been used for different seeds (e.g., cotton replicates at 120 times, but soybeans at only 36 times).

Monsanto also did not differentiate between breach of different provisions and for different types of breach. Here, McFarling only replanted seeds, a relatively controlled type of breach. Monsanto stressed that selling or otherwise disseminating the seeds would have had much more grave consequences. This argument, however, only reinforced the court's position that the damages multiplier should have been crafted to address different degrees of breach.

In conclusion, the court held the liquidated damages clause unenforceable, and remanded the case for determination of actual damages.

PSY
2 March 2005

[1] When considering different contexts, one would necessarily analyze the various rights limited by the technology license in accordance with those granted with the patent (see, 35 U.S.C. 271). For example, rights to make and sell patented articles certainly do not flow from the simple purchase of a patented product, even under the exhaustion doctrine. At most, the exhaustion doctrine may permit the sale of the same copy bought. A technology license clearly may preclude such activities despite the sale. Remanufacturing of the purchased article may also be limited by agreement or the operation of law. However, most products other than biological ones do not naturally "make" other infringing copies by their very nature.