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THE DOCTRINE OF LICENSEE ESTOPPEL IN CANADA

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An inventor acquires a patent for their invention, and licenses it to a third party who will commercialize it. The third party (licensee) agrees to pay royalties to the inventor (licensor) from the sales of the patented invention. Later, the licensee earns profits from sales of the licensor's invention, but fails to pay the licensee the royalties that are owed under their agreement. The licensee says that the licensed patent, although it remains in good standing, is invalid.

Can a licensee avoid payment of royalties by claiming that the licensed patent is invalid?

On its face, the licensee's position is unfair. The licensee has benefitted from the patent, through its own use or sublicensing of the patent. How is it that the licensee can withhold payment of royalties to the licensor, then wait until the patent is later held to be invalid, and in the meantime keep the financial gains it enjoyed while the patent was valid, without sharing those gains with the licensor?

The law in Canada recognizes the commercial irrationality and fundamental unfairness in this situation, and it does not relieve licensees from their obligation to pay royalties under a license agreement through a claim of patent invalidity. Canadian courts have long recognized an estoppel arising in a licensor/licensee relationship that operates to bar licensees from avoiding the payment of royalties by alleging that a licensed patent is invalid. (The situation is decidedly different in the United States.)

For example, in the 1925 case of *Bull v. Williams Piano Co. Ltd.*^[1], the Ontario Supreme Court considered a licensor's claim for royalties against a licensee. The plaintiff was the inventor and patentee of improvements in player piano "actions" (the programmed music for a player piano) and had granted the defendant company the exclusive license to manufacture and sell actions with the plaintiff's improvement for 18 years from the date of the agreement. The defendant company agreed to pay the plaintiff \$10 as a license fee for every one of the actions manufactured by it. The defendant company proceeded to manufacture and sell the player piano actions covered by the plaintiff's patents and pay the royalties to the plaintiff for about 12 years, when the payment of royalties ceased. The defendant company stopped paying royalties on the basis that, among other things, the patents were allegedly never properly issued and were invalid.





The Court in *Bull* rejected the licensee's defence of patent invalidity, as follows:

Effect cannot be given to the first defence after the lapse of 12 years and the use and enjoyment during those years of the patents alleged to be invalid, particularly in the absence of any evidence to shew loss or damage by reason of the alleged want of novelty; and the defendant company as licensee, is estopped from questioning the validity of the patents covered by the license, the benefit of which the company has enjoyed. A licensee cannot dispute the validity of a patent; and its invalidation is not a defence to an action for royalties, in the absence of a warranty of validity and in the absence of fraud – and such a warranty will not be implied. (emphasis added)

The doctrine of licensee estoppel was recognized more recently by the Ontario Court of Justice, in *Bayer Aktiengesellschaft v. Apotex Inc.*^[2], where the Court held, beginning at para. 44:

44. ... *It is well-recognized that if an action is brought against a licensee under the licence to enforce its provisions, then the licensee is estopped from later challenging the validity of the patent. Thus, estoppel arises by reason of the nature of the relationship between licensor and licensee and depends upon the existence and is co-extensive with the continuance of that relationship. ...*
45. *This rule has been adopted in Canada. Hogg J. in Coyle v. Sproule (1941), 2 C.P.R. 125 at 127 (Ont. H.C.) in referring to both English and Canadian decisions stated:*

The licensee of a patent, under agreement with the patentee, so long as he continues to act under the license, or during the continuation of the agreement, is not at liberty to dispute the validity of the patent. He is estopped from disputing the validity of the patent.

The Court explained the rationale for the estoppel as follows, at para. 47:

The rationale for licensee estoppel is that one may not enter into a licence and thereby obtain immunity from a claim by the patentee for infringement, use the claimed invention, yet seek to deny the patentee's rights and avoid paying royalties. The corollary is that where the patentee sues for infringement for acts outside the licence, the licensee, having lost the benefit of immunity from suit, is not bound by licensee estoppel. In other words, in a normal licence relationship, estoppel applies by reason of the bargain in place between the licensor/patentee and licensee. The licensor/patentee has foregone the right to claim infringement against its licensee and limits itself to a claim for royalties. In turn, because the licensee is insulated from an infringement claim, it foregoes any right to allege invalidity of the patent. But when the patentee asserts a claim outside of that licence relationship and seeks to make infringement an issue, the licensee is similarly freed from any restriction in attacking patent validity.





Licensee estoppel is well established in Canadian law. Over the past century and longer, Canadian courts have consistently rejected the defences advanced by licensees who have sought to avoid the payment of royalties by denying the validity of the licensed patent.^[3] The authorities establish that, unless the licensor has expressly warranted the validity of the patent, the licensor's action is on the promise to pay royalties, and the validity of the patent is immaterial.

^[1] [1925] O.J. No. 323 (S.C.).

^[2] [1995] O.J. No. 141 (Gen. Div.), rev'd on other grounds [1998] O.J. No. 3849 (C.A.).

^[3] See e.g., ***Duryea v. Kaufman***, [1910] O.J. No. 814 (H.C.J.) at paras. 14-27; ***Anderson v. E.J. Shepard Ltd.*** [1930] O.J. No. 14 (S.C. - App. Div.) at paras. 21-23; ***Coyle v. Sproule***, [1942] O.R. 307-313 (H.C.J.); ***Dableh v. Ontario Hydro***, [1993] F.C.J. No. 924 (T.D.) at paras. 116-120, aff'd on other grounds [1996] F.C.J. No. 767 (C.A.).

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