INSIDE THE MINDS

Intellectual Property Licensing Strategies

Leading Lawyers on Educating Clients, Drafting Licensing Agreements, and Resolving Disputes

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Mistakes to Avoid in Crafting an IP License: What to Watch for to Avoid Creating Issues in Later Litigation

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Introduction

When parties initially negotiate a license agreement, they sometimes have difficulty imagining the relationship souring. The excitement and promise of the new business relationship can tend to dominate the parties' approach to the licensing negotiation. The parties can envision themselves working together in harmony for years to come, and do not consider the what-ifs that sometimes arise. However, these what-ifs often do arise, whether from factors outside the parties' control, or from changing circumstances among or between the parties themselves. By the time they do arise, it is often too late. The license agreement has been in place, and its terms will affect how your litigation unfolds. Moreover, what parties often fail to realize is that the license agreement not only affects litigation between the parties over issues involving the license agreement itself, but it can also affect litigation with third parties over the licensed IP rights.

Often, a new client comes to us with a license agreement that they would like to enforce, or an agreement under which they are trying to operate and would like to understand their rights. Other times, a client would like to enforce patents of theirs that are subject to licenses to third parties. In many instances, the existing agreement includes provisions or omissions that can create issues for the client during litigation—issues that in many cases could have been avoided. This chapter discusses some of the most frequently encountered issues with license agreements and offers suggestions for dealing with those issues.

Exclusive Licenses

Exclusive licensing can be a powerful tool for both the licensor and the licensee. Where a licensee has exclusive rights under a license agreement, that licensee is the only party authorized to exercise those rights. Depending on the rights licensed, the exclusive licensee can make, use, and sell the licensed technology without the threat of competition from other licensees, and if properly worded, without competition from the licensor. Accordingly, many prospective licensees are willing to pay more for an exclusive license. From the licensor's perspective, the exclusive license offers a one-stop licensing opportunity and generally with a higher royalty rate. However, if the pitfalls of exclusive licenses are not carefully considered, they can lead to serious consequences for the parties.

Standing to Sue for Infringement and Necessary Parties to Litigation

One fundament right associated with patents that can be conveyed to the exclusive licensee is the right to sue for infringement. Parties should consider carefully the implications of their exclusive licensing arrangement as it could affect who has standing to sue for infringement of the underlying IP rights. Moreover, parties should be aware that the license could dictate whether the licensor or licensee can bring suit individually, or whether both parties must join in the litigation if suit is to be brought. Without considering these issues up front, a party to an agreement may find themselves unable to enforce their rights without the full cooperation of each other.

The Patent Act provides that a patentee has a remedy by civil action for patent infringement. 35 U.S.C. § 281. The term "patentee " is defined in 35 U.S.C. § 100(d) as including not only the person to whom the patent issued, but the successors in title to the patentee. This has been interpreted to require that a suit for infringement must ordinarily be brought by a party holding legal title to the patent. Accordingly, an assignee generally has standing to sue for infringement in its own name. The Supreme Court addressed the issue of standing to sue as far back as the nineteenth century in the case of *Waterman v. Mackenzie*. In this case, the Court stated that an assignment by the patent owner of the whole of a patent, an undivided part or share of the patent right, or all rights in a specified territory gives an assignee the right to bring an infringement action in his or her own name. *Waterman v. Mackenzie*, 138 U.S. 252 (1891).

Whether an exclusive licensee has standing to sue for infringement, then, depends on the rights granted under the license agreement and whether the agreement is effectively an assignment rather than a mere license. If an exclusive license agreement transfers "all substantial rights" to the patent(s) and "the surrounding circumstances indicated an intent to do so," then the license may be considered an assignment for purposes of standing. *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 874 (Fed. Cir. 1991); see, also, *Morrow v. Microsoft Corp.*, 499 F.3d 1332, 1340 (Fed. Cir. 2007). In other words, where a patent owner transfers all substantial rights to the patent in a license agreement, this confers constitutional standing on the assignee to sue for infringement in its own name alone.

What the exclusive licensor patent owner must be aware of in these situations, however, is that even though he or she remains the legal title owner of the licensed patents, he or she no longer has the ability to bring an infringement action without the joinder of the exclusive licensee. Accordingly, an exclusive license can give rise to a situation where the patent owner can no longer bring suit for infringement of his or her patents without cooperation from the licensee.

In many cases, the exclusive license expressly grants to the licensee the right to sue third parties for infringement, and does not reserve any rights in the licensor for sale and marketing of the patented technology. Such licenses typically are considered as assignments and confer standing to sue on the licensee. However, the courts have held that licenses that fall short in these areas can result in the exclusive license not being considered an assignment for purposes of the standing requirement. Indeed, courts have found that the retained right "is the most important factor in determining whether an exclusive license transfers sufficient rights to render the licensee the owner of the patent." *Alfred E. Mann Found. for Sci. Research v. Cochlear Corp.*, 604 F.3d 1354 (Fed. Cir. 2010).

In the *Alfred E. Mann Found* (AMF) case, the Court of Appeals for the Federal Circuit found that AMF had proper standing to sue defendant Cochlear for patent infringement, despite a license that AMF previously granted to Advanced Bionics. In the AMF case, the license granted by AMF to AB included the right to grant sublicenses to accused infringers. An outline of the key terms of the AMF license agreement to AB is provided in Appendix C.

Express covenants can be used to govern behavior between the licensor and licensee, but the contract cannot alter the statutory requirement that the suit be brought by the "patentee." *Independent Wireless Telegraph Co. v. Radio Corp. of America*, 269 U.S. 459 (1926); *Abbott Labs. v. Diamedix Corp.*, 47 F.3d 1128 (Ill. 1995). A licensee with sufficient proprietary interest in a patent has standing regardless of whether the right to sue is expressly granted in the licensing agreement. Likewise, a right to sue clause cannot negate the requirement that, for co-plaintiff standing, a licensee must have beneficial ownership of some of the patentee's proprietary rights. A patentee may not give a right to sue to a party who has no proprietary interest in the patent. *Crown Die & Tool Co. v. Nye Tool & Machine Works*, 261 U.S. 24, 44 (1923).

Where the licensor retains a right to sue accused infringers, that right often precludes a finding that all substantial rights were transferred to the licensee. Id. Retained litigation rights were sufficient to preserve the licensor's ownership of the patents-in-suit even when those rights failed to give the licensor complete control over the litigation it initiated; instead, the licensor and licensee would have joint control of the litigation. *AsymmetRx Inc. v. Biocare Med. LLC,* 582 F.3d 1314, 1321 (Fed. Cir. 2009).

However, if the licensor's right to sue is rendered illusory by the licensee's ability to settle licensor-initiated litigation by granting royalty-free sublicenses to accused infringers, then a court may find that less than all substantial rights were transferred. *Speedplay Inc. v. Bebop Inc.*, 211 F.3d 1245, 1251 (Fed. Cir. 2000). The courts have found that a licensee's right to grant royalty-free sublicenses to defendants sued by the licensor rendered illusory the licensor's right to sue. Id. at 1251. In contrast, courts have found that the licensor's right to sue was *not* illusory because any sublicenses the licensee might grant included the requirement to pay royalties. Id., citing *Abbott* at 1132.

Licensors and licensees must also be aware that the exclusive license may give rise to the situation where both the licensor and licensee are deemed to be necessary parties to an infringement action brought to enforce the licensed patents. A licensee may obtain sufficient rights in the patent to be entitled to seek relief from infringement, but to do so, it ordinarily must join the patent owner. Unlike the patentee or actual assignee of the patent, however, an exclusive licensee ordinarily may not sue in its own name alone, but must join the patent owner in an action brought against an accused infringer. *Propat Int'l Corp. v. RPost US Inc.*, 473 F.3d 1187, 1193 (Fed. Cir. 2007). Typically, the courts will look to determine whether the accused infringer would be subjected to multiple actions for infringement if the patent owner were not joined as a necessary party. Cases have held that participation of the patent owner "as a party is indispensable not only to give jurisdiction under the patent laws, but also in most cases to enable the alleged infringer to respond in one action to all claims of infringement for his act." *Independent Wireless*, 269 U.S. at 468.

When there is an exclusive license agreement, as opposed to a nonexclusive license agreement, but the exclusive license does not transfer sufficient rights to make the licensee the patent owner, either the licensee or the licensor may sue, but both of them generally must be joined as parties to the litigation. *Aspex Eyewear Inc v. Miracle Optics Inc. Viva Optique Inc*, 434 F.3d 1336, 1344 (Fed. Cir. 2006). The licensee must be aware that, as the owner of the patent, even if he or she refuses or is unable to join an exclusive licensee as co-plaintiff, there are circumstances in which a licensee may make him or her a party defendant by process. *Independent Wireless*, 269 U.S. at 468.

Important to this determination is whether the exclusive licensee also granted the exclusive right to sue for infringement of the licensed patents. *Vaupel*, 944 F.2d at 875; see also *Abbott*, 47 F.3d at 1132. The Federal Circuit has held that the nature and scope of the exclusive licensee's purported right to bring suit, together with the nature and scope of any right to sue purportedly retained by the licensor, is the most important consideration in determining whether all substantial rights were transferred to the licensee. *Alfred,* 604 F.3d 1354; citing *AsymmetRx Inc. v. Biocare Med. LLC*, 582 F.3d 1314, 1320-21 (Fed. Cir. 2009).

A few recent federal circuit decisions shed some light on these issues. In the notable patent case cited above, *Abbott*, the patent owner had retained too great an interest in the patents to enable the licensee to sue for infringement on its own. Those interests included "a limited right to make, use, and sell products embodying the patented inventions, a right to bring suit if [the licensee] declined to do so, and the right to prevent [the licensee] from assigning its rights under the license to any party other than a successor in business." *Abbott*, 47 F.3d at 1132. More specifically, the agreement stated that if the patent owner asked the licensee to bring suit against an alleged infringer and the licensee declined to do so, the patent owner had the right to bring its own infringement action. Thus, although the licensee had the option to initiate a suit for infringement, "it [did] not enjoy the right to indulge infringements, which normally accompanies a complete conveyance of the right to sue." Id. at 1132. In addition, even if the licensee did exercise its option to sue for infringement, it was "obligated under the agreement not to 'prejudice or impair the patent rights in connection with such prosecution or settlement.'" Id.

In contrast to this, the exclusive license considered in the *Vaupel* case granted the right to sue to the licensee in its entirety, subject only to the obligation to inform the patent owner of the existence of the suit. In this case, because the licensor retained only limited rights, the court found that the patentee was not a necessary party and the licensee had standing to sue on its own. *Vaupel*, 944 F.2d at 875. It is instructive, then, to understand what rights the patent owner did retain in *Vaupel*. The only rights under the licensed patent retained by the patent owner were:

- A veto right on sublicensing
- The right to obtain patents on the invention in other countries
- A reversionary right in the patent in the event of bankruptcy
- A right to receive infringement damages

In this circumstance where there was a *complete* transfer of the right to sue for infringement, the limited rights retained did not reduce the transfer of patent rights to a mere license, because they did not substantially interfere with the full use of the exclusive rights under the patent and were thus not inconsistent with an assignment. Id. at 875.

Oftentimes, exclusive licensees will grant exclusivity only in a particular territory, or only in a particular field of use. What effect, if any, do these territorial and field-of-use restrictions have on considerations relating to standing and necessary parties? Generally speaking, an exclusive license of the entire bundle of rights for a defined territory gives the exclusive licensee standing to sue for infringement in that territory. *Enzo APA & Son v. Geapag A.G.*, 134 F.3d 1090, 1093, (Fed. Cir. 1998). Even where a license is exclusive, if it is granted only in a limited territorial region and is only for a limited field-of-use in that region, it does not give the licensee standing to sue for infringement in that region without joinder of the legal patent owner. *Int'l Gamco Inc. v. Multimedia Games Inc.*, 504 F.3d 1273, 1275-279, (Fed. Cir. 2007). This is because field-of-use licenses divide the patent rights among multiple entities. In this situation, if the exclusive licensee in a particular field were permitted to bring suit by itself, the possibility that the accused infringer would be subject to multiple infringement actions arises as the patent rights are shared among various entities.

Reversion

When granting exclusive rights in your intellectual property, you should consider including a provision for reversion of the litigation rights to the licensor in the event of a breach or termination of the agreement. Standing is determined upon commencement of the action. Therefore, a licensee deemed to have standing can bring a lawsuit for patent infringement. The courts have found that where an agreement makes no express provision of reversion rights back to the licensor, the right to sue does not revert back to the licensor for a litigation properly brought by the licensee even after the licensee breached the license agreement and it was terminated. *Master Craft Tool Co. LLC v. Stanley Works*, 2007 WL 2008685 (D. Minn. July 6, 2007)

Set Minimum Performance Requirements

Although performance thresholds are typically not a topic that gives rise to issues in litigation, it is an important point to keep in mind when entering into an exclusive license and is therefore worthy of brief mention. One issue that can arise with exclusive licensees is the licensee's failure to commercialize the technology in accordance with anticipated expectations. If a licensor has given the licensee exclusive rights in the technology, even if only in a particular field of use or territory, that licensee is expected to perform. If the licensee fails to perform, the licensor is losing value. Accordingly, the exclusive licensor should build minimum performance requirements into the exclusive license agreement. These can be in the form of minimum sales quotas, minimum marketing expenditures, minimum market share goals, and so on.

Specific remedies for failure to meet the required minimums can and should be built into the agreement. One such remedy is a minimum royalty. In this scenario, the licensee can be required to pay a minimum royalty regardless of the amount of sales the licensee actually makes. In this way, the exclusive licensor can be guaranteed a minimum stream of revenue even if the licensee fails to commercialize the technology as expected. This puts the burden on the licensee to perform as promised while removing some or all of the risk. Another remedy is conversion of the license from exclusive to non-exclusive. With this remedy, the licensor is not "stuck" with the original licensee and can then offer licenses to others to commercialize the technology. However, a downside of this conversion remedy is that the licensor will not be able to offer exclusivity to anyone else. Therefore, another remedy available is termination of the license agreement entirely. With the license terminated and the original licensee removed from the picture, the licensor is free to offer the technology to others on an exclusive or non-exclusive basis.

The License's Impact on Damages

Accrual of Damages and Patent Marking Provisions in Licenses

If licenses are granted under your patents, you should include a provision requiring that licensees properly mark each covered product sold with the patent number. Failure to do so can limit the damages to which you are entitled. As a patent owner, you are entitled to collect damages for infringement that occurs prior to filing your infringement suit, but only if the defendant was put on notice of his or her infringement. This requirement for notice is set forth in the Section 287 of the Patent Act, which provides, in pertinent part:

> Patentees, and persons making, offering for sale, or selling within the United States any patented article for or under them or importing any patented article into the United States, may give notice to the public that the same is patented, either by fixing thereon the word "patent" or the abbreviation "pat.," together with the number of the patent . . . In the event of failure so to mark, no damages shall be recovered by the patentee in any action for infringement, except on proof that the infringer was notified of the infringement and continued to infringe thereafter, in which event damages may be recovered only for infringement occurring after such notice. Filing of an action for infringement shall constitute such notice.

35 U.S.C. § 287(a) (1999).

Such notice can be provided by actual or constructive notice to the accused infringer. Actual notice can be provided by a letter informing the accused infringer of the identity of the patent and the products or activities that are believed to be an infringement, accompanied by a proposal to abate the infringement, whether by license or otherwise. *SRI Int'l v. Advanced Tech. Lab.*, 127 F.3d 1462, 1470 (Fed. Cir. 1997). Constructive notice can be provided by the patentee marking the product in compliance 35 U.S.C. § 287(a) of the patent laws. Absent marking, damages may be recovered only after actual notice is given. *SRI Int'l*, 127 F.3d at 1469.

Of importance to licensors is the fact that the marking provisions also apply to "persons making or selling any patented article for or under [the patentees]." 35 U.S.C. § 287. These provisions also apply to patentees who do not make or sell any products themselves, but who license others to manufacture and sell patented articles in the United States. *Amsted Indus. Inc. v. Buckeye Steel Castings Co.*, 24 F.3d 178, 184-85 (Fed. Cir. 1994). Along these lines, courts have held that licensees and other authorized parties such as manufacturers must also comply with the marking requirements, or damages will not accrue. *Amsted Indus.*, 24 F.3d at 185. Therefore, the licensor is advised to include in its license agreements provisions requiring licensees to mark licensed products and to police the marking to ensure compliance.

What happens, though, if your licensees fail to mark licensed products despite a properly drafted license agreement requiring marking? Section 287(a) requires that "substantially all" patented articles be marked to constitute constructive notice and that the marking must be substantially consistent and continuous. 35 U.S.C. § 287(a). Fortunately, the courts recognize that with third parties unrelated to the patentee, such as licensees, it may be difficult for a patentee to ensure complete compliance with the marking provisions. Therefore, the courts may apply a "rule of reason" approach in such a case, and substantial compliance may be found to satisfy the patent statute. When the failure to mark is caused by someone other than the patentee, courts may consider whether the patentee made reasonable efforts to ensure compliance with the marking requirements. *Maxwell v. J. Baker Inc.*, 86 F.3d 1098, 1111-112 (Fed. Cir. 1996). Accordingly, licensors should make at least reasonable efforts to enforce marking provisions in their license agreements.

Damages Calculations

Licensees should be aware that royalties set forth in licensing agreements might be used as a guide to determining damages that can be awarded in a suit to enforce the patents. In certain circumstances, patentees will grant a license to a third party at a below-market rate for a variety of reasons. For example, the licensee may be a friend or past colleague, the licensor may be looking to stimulate the market, the licensor may be looking to quickly resolve a dispute, or the licensor did not appreciate the actual value of the licensed technology. However, while the licensor may be entitled to argue that these special-circumstance licenses should not be considered in determining royalties in litigation, these licenses can become an issue for the licensor.

Section 284 of the 1952 Patent Act provides, in part:

> Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer...

35 U.S.C. § 284 (1999).

The statute contemplates that when a patentee is unable to prove he or she is entitled to lost profits, margin erosion, or an established royalty rate, the patentee is at least entitled to "reasonable royalty" damages. As such, reasonable royalties are sometimes viewed as a floor for patent damages. In what has become one of the most relied upon cases for damages analysis, *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, the court set forth a detailed list of fifteen factors that may be relevant in determining a reasonable royalty. *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified and aff'd*, 446 F.2d 295, (2d Cir. 1971), *cert. denied*, 404 U.S. 870 (1971). These factors, which are routinely relied on for damages analysis, have come to be referred to as the "Georgia Pacific Factors." Several of these factors include considerations of past royalties received by the patentee for licensing the patent in suit:

- The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.
- The rates paid by the licensee for the use of other patents comparable to the patent in suit.
- The nature and scope of the license, as exclusive or non-exclusive, or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold.

- The licensor's established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly.
- The commercial relationship between the licensor and licensee, such as, whether they are competitors in the same territory in the same line of business, or whether they are inventor and promoter.
- The effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.
- The duration of the patent and the term of the license.

As these factors illustrate, past licensing practices, not just royalties, can affect patent damages in an infringement action under a previously licensed patent. Indeed, courts have held that licenses granted by the patent for the patent in suit must be considered, and that failure to do so is an error of law. *Studiengesellschaft Kohle v. Dart Industries Inc.*, 862 F.2d 1564, 1568 (Fed. Cir. 1988). The licensor must be aware that licenses that suggest a lower rate have in some cases been deemed to carry considerable weight. See, for example, *Unisplay, S.A. v. American Elec. Sign Co.*, 69 F.3d 512, 519 (Fed. Cir. 1995). In fact, some courts have gone so far as to state that if reasonable royalty damages are set differently from the licensing history, the court must justify the difference. *Studiengesellschaft*, 862 F.2d at 1568.

However, damages calculations are always dependent on the facts and circumstances of the case, and exceptions have been made in certain circumstances. For example, it has been stated that a single licensing agreement does not generally demonstrate uniformity or acquiescence in the reasonableness of the royalty rate. Instead, for a royalty rate to be considered "established," it must be paid by a sufficient number of licensees such that a general acquiescence in its reasonableness can be shown. *Rude v. Westcott*, 130 U.S. 152, 165 (1889). However, it would still be wise for the licensor to avoid the situation where even a single license is granted at below-market rates.

Some areas can provide somewhat of a safe haven for damages analysis. For example, Rule 408 of the Federal Rules of Evidence provides a restriction on the use of evidence regarding offers to compromise a dispute. FRE 408 excludes the introduction of compromise offers "to prove liability for or invalidity of the claim or its amount" and further excludes "[e]vidence of conduct or statements made in compromise negotiations." Thus, settlement negotiations among the parties are often conducted with the understanding that the parties are free to make settlement offers, without the settlement offer being introduced into evidence as the alleged value of a claim. Where the settlement offer involves an offer to license intellectual property, FRE 408 can also provide protection to the IP holder. Licensing offers in compromise made in contemplation of infringement litigation have been found to be inadmissible for damages analysis under Rule 408 of the Federal Rules of Evidence.

Also, in *Hanson v. Alpine Valley Ski Area Inc.*, 718 F.2d 1075, 1078-79 (Fed. Cir. 1983), the Federal Circuit found that the fact that licenses were offered at a particular rate does not show that that rate was the "established" rate, because showing an established rate requires actual licenses, not mere offers to license. Moreover, because in that case offers were made after the infringement had begun and litigation was threatened or probable, their terms "should not be considered evidence of an 'established royalty,'" since "license fees negotiated in the face of a threat of high litigation costs 'may be strongly influenced by a desire to avoid full litigation. . . .'" Id. at 1078-79; see also *Panduit Corp. v. Stahlin Bros. Fibre Works Inc.*, 575 F.2d 1152, 1164 (6th Cir. 1978).

However, there are cases that can be considered in contrast to *Hanson*. For example, in *Deere & Co. v. Int'l Harvester Co.* the Federal Circuit found error where evidence of a third party license negotiated during infringement of the subject patent was excluded. *Deere & Co. v. International Harvester Co.*, 710 F.2d 1551 (Fed. Cir. 1983). Although the third party license was negotiated while the litigants in that action were "locked in disputes over [the] validity and infringement of the ... patent," the Court concluded that the third party license was not itself inadmissible evidence of the settlement of the dispute between the parties. The court in *Deere* found that Rule 408 is limited to actual disputes over existing claims. The court therefore found that Rule 408 did not apply to the licensing offers, including rejected offers, for a patent that is not yet the subject of a lawsuit, as that offer was not an offer by Deere for settlement of a disputed claim. *Deere*, 710 at 1557.

Venue and Forum Selection

In those circumstances when the relationship does break down and dispute resolution mechanisms are considered, the agreement will often provide guidance as to what law applies and where disputes are resolved. As it was so aptly put by Judge Cardamone: "A plaintiff may think that as the initiator of a lawsuit he is the lord and master of where the litigation will be tried and under what law. But if he is a party to a contract that contains forum selection and choice of law clauses his view of himself as ruler of all he surveys may, like an inflated balloon, suffer considerable loss of altitude." *Phillips v. Audio Active Ltd.*, 494 F.3d 378, 381 (2d Cir. N.Y. 2007). Accordingly, forum selection and choice of law provisions should be considered carefully by the parties and not glossed over in negotiations. Also, care should be taken when drafting such provisions so as to effectuate the parties' intentions.

When negotiating a contract, you should consider where breaches are at the greatest risk of occurring, the nature of such likely breaches, the likely breaching party, and the desired remedies. Only after these are considered can the proper forum be selected. The parties should consider whether they want disputes under the agreement to be arbitrated or whether they will head to court to resolve their differences. The parties should also consider which country's or state's laws will govern their agreement and in which jurisdiction they wish to arbitrate or litigate their disputes. A license agreement is a contract, and in the United States contract disputes are generally governed under state law.

If the parties want to have their disputes arbitrated, they should include an arbitration provision in their license agreement. Absent an agreement to submit disputes to arbitration, one party typically cannot compel the other to submit to arbitration to resolve their dispute. *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582, (1960) ("arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."). When included in the license agreement, an arbitration provision can set forth whether disputes are arbitrated, the types of disputes submitted to arbitration, the process for arbitration, and rules governing the arbitration process. Many agreements even map out a pre-arbitration process for resolving disputes among the parties before submitting the matter to arbitration. The Federal Arbitration Act at 9 U.S.C.S. § 1 et seq allows parties to tailor many facets of arbitration in their agreement, including, for example, the way arbitrators are chosen, what their qualifications should be, which issues are arbitrable, along with procedure and choice of substantive law. *Hall St. Assocs. L.L.C. v. Mattel Inc.*, 552 U.S. 576, 586 (U.S. 2008).

If a dispute arises under an agreement and one of the parties files suit in a court of law where a properly drafted arbitration clause was included in the agreement, and if the dispute falls under the arbitration provision, the other party can (and typically does) move to stay that action and compel arbitration. Courts do have the power to compel the party who filed suit to proceed with the arbitration even in cases where the arbitration is located in some other jurisdiction.

However, as with the rest of the contract, the express language in the agreement is key. Courts have held that an agreement to arbitrate disputes "arising out of" or "arising under" the agreement does not cover disputes that are merely "related to" the agreement. *Tracer Research Corp. v. National Envtl. Servs. Co.*, 42 F.3d 1292, 1295 (9th Cir. Ariz. 1994). The Ninth Circuit held, for example, that a licensee's alleged post-termination use of licensed trade secrets was not susceptible to arbitration as arising "under" the agreement. Id. at 1295. Accordingly, if the parties wish to be able to compel arbitration for disputes that relate to the subject matter of the agreement in addition to those that arise under the agreement, you should consider using "arising out of *or relating to*" language to ensure that all claims touching matters covered by the agreement are arbitrable. *Genesco Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 845 (2d Cir. 1987); See, also *Rhone-Poulenc Specialities Chimiques v. SCM C*orp., 769 F.2d 1569, 1571 (Fed. Cir. 1985).

The parties can also identify forum selection for different disputes in the agreement. Choice of law and forum selection clauses set forth in a license agreement are typically honored by the courts. Indeed, the Supreme Court has held that where forum selection clauses freely negotiated between the parties are included in the agreement, they are generally valid and enforceable. *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (U.S. 1972) ("in the light of present-day commercial realities and expanding international trade we conclude that the forum clause should control absent a strong showing that it should be set aside."). Where a party files suit under the agreement in a jurisdiction contrary to a clear forum selection clause contained in that agreement, the action is subject to dismissal for improper venue. Likewise, the courts give substantial weight to choice of law provisions. *Phillips v. Audio Active Ltd.*, 494 F.3d 378, 384 (2d Cir. N.Y. 2007); See, also, *State Trading Corp. of India Ltd. v. Assuranceforeningen Skuld*, 921 F.2d 409, 417 (2d Cir. 1990) ("[A] contractual choice of law clause generally takes precedence over choice of law rules . . . .").

The courts, however, have frequently classified forum selection clauses as either mandatory or permissive, so it is important to be careful when drafting the forum selection clause. *Excell Inc. v. Sterling Boiler & Mech. Inc.*, 106 F.3d 318, 321 (10th Cir. 1997). "Mandatory forum selection clauses contain clear language showing that jurisdiction is appropriate only in the designated forum." Id. at 321. "In contrast, permissive forum selection clauses authorize jurisdiction in a designated forum, but do not prohibit litigation elsewhere." Id. Language of a forum selection clause that does not specify exclusivity of the forum can be construed as permissive rather than mandatory. C*itro Florida Inc. v. Citrovale S.A.*, 760 F.2d 1231, 1232 (11th Cir. 1985) (concluding that language of a forum selection clause that addressed jurisdiction using nonexclusive language could reasonably be construed as a permissive forum selection clause); *see*, also, *Keaty v. Freeport Indonesia Inc.*, 503 F.2d 955, 957 (5th Cir. 1974).

In contrast, where venue is specified in a forum selection clause with sufficient clarity and certainty to be considered obligatory, the clause will be enforced. *K & V Scientific Co. Inc. v. Bayerische Motoren Werke Aktiengesellschaft (BMW)*, 314 F.3d 494, 498 (10th Cir. 2002). However, the parties negotiating the license should be aware that where the forum selection clause only specifies jurisdiction, the courts in several circuits have not enforced the clause unless there is some further language indicating the parties' intent to make venue exclusive. *Paper Express Ltd. v. Pfankuch Maschinen GmbH*, 972 F.2d 753, 757 (7th Cir. 1992); *John Boutari & Son, Wines & Spirits, S.A. v. Attiki Imp. & Distrib. Inc.*, 22 F.3d 51, 52 (2d Cir. 1994); *Docksider Ltd. v. Sea Tech. Ltd.*, 875 F.2d 762, 764 (9th Cir. 1989); *Citro Florida*, 760 F.2d at 1232; *Keaty v. Freeport Indonesia Inc*., 503 F.2d 955, 957 (5th Cir. 1974). Applying this rule, these circuits (and the district courts within them) have held the following forum selection clause language to be permissive:

- "Any dispute arising between the parties hereunder shall come within the jurisdiction of the competent Greek Courts, specifically of the Thessaloniki Courts." *John Boutari*, 22 F.3d at 52.
- "The laws and courts of Zurich are applicable." *Caldas*, 17 F.3d at 127.
- "The courts of California, County of Orange, shall have jurisdiction over the parties in any action at law relating to the subject matter or the interpretation of this contract." *Hunt*, 817 F.2d at 76.
- "Place of jurisdiction is Sao Paulo/Brazil." *Citro*, 760 F.2d at 1231.
- "This agreement shall be construed and enforceable according to the law of the State of New York and the parties submit to the jurisdiction of the courts of New York." *Keaty*, 503 F.2d at 956.
- "This agreement shall be governed by and construed in accordance with the laws of the Federal Republic of Germany. * * * Place of jurisdiction shall be Dresden." *Hull 753 Corp.*, 58 F. Supp. 2d at 926.

In contrast, courts have held clauses mandatory where the language of the clause is clear and unambiguous. Applying the same rule, these courts have held the following clauses to be mandatory:

- "Place of jurisdiction . . . is the registered office of the trustee [in Germany], to the extent permissible under the law." *Frietsch v. Refco Inc.*, 56 F.3d 825, 827, 829 (7th Cir. 1995); (concluding that the phrase "to the extent permissible under the law" "would have no function if the [forum selection] clause were not mandatory—if, in other words, a party could sue anywhere he wanted").
- "In all disputes arising out of the contractual relationship, the action shall be filed in the court which has jurisdiction for the principal place of business of the supplier . . . . The supplier also has the right to commence an action against the purchaser at the purchaser's principle place of business." *Paper Express Ltd. v. Pfankuch Maschinen GmbH*, 972 F.2d 753, 755-756 (concluding the last sentence "would be appropriate and meaningful only if the clause were in fact mandatory").
- "Licensee hereby agrees and consents to the jurisdiction of the courts of the State of Virginia. Venue of any action brought

hereunder shall be deemed to be in Gloucester County, Virginia." *Docksider Ltd.*, 875 F.2d at 763.

The only circuit that has deviated from the above framework is the Sixth Circuit. That court interpreted the following forum selection clause as requiring exclusive jurisdiction.

- "Place of jurisdiction for all disputes arising in connection with the contract shall be at the principal place of business of the supplier. This shall also apply for claims in summary procedures on bills of exchange, promissory notes, or checks. The supplier is also entitled to file a suit at the principal place of business of the purchaser." *General Electric Co. v. G. Siempelkamp GmbH & Co.*, 29 F.3d 1095, 1097 (6th Cir. 1994).

In construing this clause, the Sixth Circuit concluded that, "because the clause states that 'all' disputes 'shall' be at [defendant's] principal place of business, it selects German court jurisdiction exclusively and is mandatory." Id. at 1099.

Accordingly, licensors and licensees are advised to be clear when setting forth their desires in the licensing agreement. If the clause is intended to be mandatory, the parties should consider stating that it is the "exclusive jurisdiction for disputes" arising under the agreement.

Licensors should also be aware that reaching out to a licensee in another state and negotiating a license agreement with that licensee in that state may subject the licensor to *in personam* jurisdiction in that territory. This will depend on the subject state's long-arm statute. California, for example, has a long-arm statute that is coextensive with the limits of due process. Accordingly, the inquiry collapses into a single inquiry—whether jurisdiction comports with due process. In the seminal case on personal jurisdiction, the Supreme Court held that "due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *International Shoe Co. v. Washington*, 326 U.S. 310, 316, (1945).

In keeping with *International Shoe* and other jurisprudence, the Supreme Court in the *Burger King* case identified the three factors that are considered when making the due process inquiry. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (U.S. 1985). These factors were summarized by the Federal Circuit in the case of *Akro v. Luker*: (1) Whether the defendant purposefully established minimum contacts within the forum State—i.e., whether its activities were "purposefully directed" at residents of the forum state; (2) whether the claim asserted "arises out of or relates to" the defendant's activities with the state; and (3) the assertion of personal jurisdiction would comport with "fair play and substantial justice." *Akro Corp. v. Luker*, 45 F.3d 1541, 1545 (Fed. Cir. 1995).

The first "minimum contacts" prong of the due process inquiry focuses on whether the defendant "has purposefully directed his activities at residents of the forum and the litigation results from alleged injuries that arise out of or relate to those activities." *Burger King*, 471 U.S. at 471-76. Following this framework, it has been held that negotiating licensing agreements with a licensee in another state (even where negotiation was accomplished by telephone and mail from your home state) and collecting royalties from the licensee in his or her own state has met the "minimum contacts" requirement of *International Shoe*. *Inamed Corp. v. Kuzmak*, 249 F.3d 1356, 1361 (Fed. Cir. 2001).

It is noted that complaints for breach of the licensing agreement are typically accompanied by one or more counts of patent infringement. Where the licensor has stated a claim arising under the patent laws in a well-pleaded complaint, the action can be said to arise under an Act of Congress related to patents, thus giving rise to exclusive jurisdiction to the federal district courts of the United States. 28 U.S.C. § 1338. In such circumstances, disputes surrounding the licensing agreement that relate to the question of infringement and defenses thereto will be joined. Likewise, where initial jurisdiction is based upon a claim of patent infringement under 28 U.S.C. § 1338 any appeals will be heard by the Federal Circuit, even in circumstances where the case turns on state law contract principles. *Kennedy v. Wright*, 851 F.2d 963 (7th Cir. 1988).

Protective Orders

In many instances, confidential information is shared among the parties in a licensing setting. For example, many licensing agreements include trade secret and know-how licenses. As another example, in a joint-development or joint venture setting, parties can exchange their existing confidential information as well as develop new confidential information. Accordingly, licensing agreements often contain confidentiality provisions to protect the parties' confidential information from unwanted disclosure. However, should one of the parties become involved in a litigation, that party could be compelled during the litigation to produce confidential information it received under the license agreement. This can occur even where the litigation does not involve the license agreement, but information obtained under the license agreement may be relevant to the dispute being litigated. Additionally, either or both parties of the license agreement could be compelled to produce confidential information under a third party subpoena, if that information is deemed relevant. Remember, parties are generally given relatively broad latitude in their discovery requests.

Therefore, when drafting your license agreement, you may want to consider including provisions to protect your confidential information in the event the other party to your license is compelled to produce some or all of that information in a subsequent litigation with a third party or under a third party subpoena. While you may not be able to prevent the other party to your agreement from producing confidential information in response to a subpoena, your license agreement can include provisions that require a protective order to be negotiated and put into effect before information is produced in a litigation setting.

Here are two example clauses:

> In the event a Receiving Party becomes compelled by law to disclose any of the Confidential Information, Receiving Party shall provide the Disclosing Party prompt written notice of such compelled disclosure so that the Disclosing Party may seek a protective order or other remedy protecting the Confidential Information, or waive compliance with the provisions of this Agreement. The Receiving Party shall, in good faith, provide reasonable cooperation to the Disclosing party in obtaining such protective order or other remedy. In the event that the Disclosing Party is unable to obtain such protective order

> or other remedy, Receiving Party will furnish only that portion of the Confidential Information that is legally required to be disclosed.
>
> Receiving Party may use or disclose Confidential Information for other than the Purpose only to the extent (i) such use is approved in writing in advance by Disclosing Party, or (ii) Receiving Party is legally compelled to disclose such Proprietary Information, provided, however, that prior to any such disclosure, Receiving Party shall give Disclosing Party reasonable advance Notice of any such disclosure and shall cooperate with Disclosing Party in protecting against or disputing any such disclosure. If unable to avoid disclosure, the Receiving Party shall cooperate with the Disclosing Party to put a proper protective order in place to protect the Confidential Information from further disclosure and/or to narrow the scope of such disclosure and/or use of the Confidential Information.

Of course, these examples are in the context of an actual agreement, so the defined terms are specific to their respective agreements.

Clarity

By far, one of the most common problems that I encounter when a party presents me with a license agreement is clarity of the language. Generally, even precise language can be subject to argument over its interpretation. Unfortunately, drafters too often use imprecise language when drafting license agreements. This leads to difficulties when trying to enforce your original intent in the license agreement. It also increases uncertainty in your business operations, and, if litigation is required, it increases litigation costs and risk.

License agreements are usually enforced in accordance with the ordinary meaning of the language without recourse to extrinsic evidence, beyond the four corners of the document itself. However, the presumption that the ordinary language of the agreement controls can be rebutted in two ways. First, the license agreement will not be interpreted literally if doing such an

interpretation would produce absurd results. This can include results that the parties would not likely have agreed to when negotiating the agreement. Second, the contract must be interpreted as a whole. *LaSalle National Trust, N.A. v. ECM Motor Co.*, 76 F.3d 140, 144 (7th Cir. 1996). However, problems are magnified when the language of the contract is unambiguous.
When a court of law sets out to interpret terms in a contract, such as a licensing agreement, the cardinal rule it follows is to give effect to the parties' intent. This intent is to be discerned from the contract language—that is, it is determined from the language within the "four corners" of the contract document itself. If the contract language is unambiguous, it should be given its plain and ordinary meaning. *Virginia Surety Co. Inc. v. Northern Insurance Co. of New York*, 866 N.E.2d 149 (Ill. 2007). However, where the language is unclear or ambiguous, the court needs to look to extrinsic evidence to construe the contract language. When this occurs, the court may consider parol evidence (i.e., oral or written evidence outside the contract that explains or even contradicts the written agreement) to determine the parties' intent. Where the court is forced to examine extrinsic evidence to interpret your contract, your litigation expenses increase, certainty of outcome generally decreases, and you risk the court settling on an interpretation that is contrary to what you originally intended.

You should also remember that contracts are generally construed against the drafting party. Restatement (Second) of Contracts § 206 (1981). If there is an ambiguity in the terms of the agreement, it will normally be resolved against the party that drafted the agreement. For example, the Fifth Circuit established in *Keaty v. Freeport Indonesia Inc.*, 503 F.2d 955 (5th Cir. 1974), and *Zapata Marine Service v. O/Y Finnlines Ltd.*, 571 F.2d 208 (5th Cir. 1978), that "when a contract provision is subject to opposing, yet reasonable interpretation, an interpretation is preferred which operates more strongly against the party from whom the words proceeded." 571 F.2d at 209. However, where sophisticated parties are involved, the courts tend to find exception with this principle and hold the parties in equal light. *Merheb v. Illinois State Toll Highway Authority*, 267 F.3d 710, 713 (7th Cir. 2001). Nonetheless, you may consider adding a clause to your agreement that states something to the effect of

> This Agreement has been negotiated between the Parties and their respective legal counsel and the Parties understand

> and agree that this Agreement is deemed to have been drafted jointly by the Parties, and that no rule of strict construction shall be applied against either party.

Conclusion

There are several ways in which a license agreement can affect litigation of your licensed IP rights. As the above examples illustrate, a license agreement can affect the process and the outcome of litigation on the underlying patent or other intellectual property rights. Moreover, the impact of the license agreement can even affect litigation actions against third parties other than the licensee. Accordingly, the parties should keep these factors in mind when drafting and negotiating license agreements, and remember that sometimes relationships do sour.

Key Takeaways

- One issue that can arise with exclusive licenses is the effect that such licenses can have on the parties' standing to sue. Depending on how the agreement is drafted, the exclusive licensee may have standing, and the licensee may be required to join the licensor as a necessary party to litigation enforcing the licensed intellectual property rights.
- Another issue that can arise with exclusive licenses is the licensee's failure to commercialize the technology in accordance with anticipated expectations. Specific remedies for failure to meet the required minimums can and should be built into the agreement. One such remedy is a minimum royalty. Another remedy is conversion of the license from exclusive to non-exclusive.
- Jurisdiction clauses in a license agreement can be subject to interpretation. Courts have frequently classified forum selection clauses as either mandatory or permissive, so it is important to be careful when drafting the forum selection clause. If mandatory jurisdiction is intended, the parties should use clear language showing that jurisdiction is appropriate only in the designated forum.
- When negotiating an IP contract, you should consider where breaches are at the greatest risk of occurring, the nature of such

likely breaches, the likely breaching party, and the desired remedies. Only after these are considered can the proper forum be selected.

- When drafting your license agreement, you may want to consider including provisions to protect your confidential information in the event the other party to your license is compelled to produce some or all of that information in a subsequent litigation with a third party or under a third party subpoena.
- Even precise language can be subject to argument over its interpretation. Unfortunately, drafters too often use imprecise language when drafting license agreements. This leads to difficulties when trying to enforce your original intent in the license agreement and can increase litigation costs.

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