JENNER&BLOCK
Intellectual Property and Technology Law Practice
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Firm Files Counterclaim in Controversy Over Title of Film "Beauty Shop"

Jenner & Block on December 2, 2003 filed a counterclaim against MGM in an effort to halt MGM's plans to release a movie entitled "Beauty Shop." One of the primary issues in the case is whether MGM or Firm client Beauty Shop, LLC has the right to use the designation "Beauty Shop" as the title of a motion picture. Beauty Shop, LLC's film project bearing that title is currently in post-production and stars actress Vivica A. Fox in the leading role. MGM also has plans to release in 2004 its own movie entitled "Beauty Shop" as an alleged spin-off of MGM's "Barbershop 2," which was released on February 6, 2004.

Mark Brown and David T. Odom are principals of Cush Productions, LLC, which owns Beauty Shop, LLC. Mr. Brown wrote and produced the original "Barbershop" movie, received an executive producer credit on "Barbershop 2," and is the writer and director of Beauty Shop, LLC's film entitled "Beauty Shop." Mr. Odom is the executive producer of Beauty Shop and is a former Jenner & Block attorney.

MGM, which produced and distributed "Barbershop," recently sued Mr. Brown and other defendants for alleged copyright infringement, trademark infringement, unfair competition and breach of contract. As reported by Reuters, in November 2000, Mr. Brown sold his script for "Barbershop" to MGM and the company alleges in its complaint that at that time, Mr. Brown agreed that all original ideas, concepts, and all sequel and prequel rights, among other things, relating to the screenplay and subsequent film belong to MGM. Mr. Brown and the other defendants deny that MGM's claims have any merit.

The counterclaim filed by the Firm alleges that MGM's use of the designation "Beauty Shop" as the title of a motion picture MGM is producing violates Beauty Shop, LLC's exclusive rights to use that designation for its motion picture. The counterclaim argues that Beauty Shop, LLC's rights to the Beauty Shop title extend from the long-running, successful Shelly Garrett 1987 stage play "Beauty Shop" and its successor plays "Beauty Shop Part 2" and "Beauty Shop: Under New Management." Beauty Shop, LLC is asking for injunctive relief as well as damages.

In a strange additional twist in this controversy, there is yet another group, including former NBA star Magic Johnson, which is producing a movie also entitled "Beauty Shop." Beauty Shop, LLC is separately pursuing legal action against this group.

Jenner & Block's team working on this matter includes Partners Reginald J. Hill and Daniel W. Smith and Associates Joseph A. Saltiel and Brian P. O'Donnell. •

Update On Prosecution Laches: Lemelson Patents Declared Unenforceable

by Daniel J. Schwartz

Daniel J. Schwartz is a partner in Jenner & Block's Chicago office and a member of the Firm's Intellectual Property and Technology Law, and Litigation Practices. His practice includes patent and trademark litigation and developing corporate strategies for both start-up and later stage technology companies. Mr. Schwartz has worked on patent litigation for some of the world's largest industrial, medical products and telecommunications companies.

He received a degree in Mechanical Engineering from Northwestern University and J.D. from Northwestern University Law School, where he served as an editor of the Journal of International Law and Business. *He co-teaches a course in intellectual property litigation at Loyola University Law School in Chicago.*

In our Spring 2002 newsletter we reported on a decision of the Court of Appeals for the Federal Circuit in *Symbol Technologies, Inc., et al. v. Lemelson Medical, Education & Research Foundation, Limited Partnership.* In that decision, the Federal Circuit confirmed that the doctrine of prosecution laches could be raised as a defense in a patent infringement action, and sent the case back to the District Court of Nevada for further proceedings. On January 23, 2004, Chief Judge Philip M. Pro of the United District Court for the District of Nevada issued his Findings of Fact and Conclusions of Law. [No. CV-S-01-701-PMP (RJJ) (D.Nev. Jan. 23, 2004)]. As discussed below, the District Court held that 14 patents owned by the Lemelson Medical, Education & Research Foundation, Limited Partnership ("Lemelson") are unenforceable under the equitable doctrine of prosecution laches and invalid due to lack of an enabling disclosure under 35 U.S.C. § 112.[1]

Background

Lemelson's patents and prosecution tactics have been widely discussed and publicized. Generally, Lemelson's patents, including the 14 patents at issue in *Symbol Technologies,* relate to machine vision and automatic identification bar code technology. Lemelson has successfully licensed and enforced these patents to hundreds of companies and received more than $1 billion in revenue. The plaintiffs in this case design, manufacture and sell bar code scanners and machine vision products.

The *Symbol Technologies* litigation began as a declaratory judgment action filed by Symbol and other parties seeking a declaration that the 14 Lemelson patents were invalid, unenforceable, and not infringed. Lemelson counterclaimed, seeking declarations that the patents were infringed. All 14 patents trace their priority to applications filed by Lemelson in 1954 and 1956. Thirteen of the patents contain a specification identical to the specification contained in a 1972 Lemelson application. Among other things, the plaintiffs asserted that Lemelson's delay of from 18 to 39 years in filing the applications that issued as the 14 patents-in-suit required a finding that the doctrine of prosecution laches barred enforcement of the patents.

Prosecution Laches

Prior to this litigation, it was unclear whether the doctrine of prosecution laches was available as a defense to an allegation of patent infringement. However, the Federal Circuit resolved this uncertainty in a decision from an earlier appeal of this same case. In that case, the Court of Appeals held that the doctrine of prosecution laches "...may be applied to bar enforcement of patent claims that issued after an unreasonable and unexplained delay in prosecution even though the applicant complied with pertinent statutes and rules." *Symbol Technologies, Inc., et al. v. Lemelson Medical, Education & Research Foundation, Ltd. Prtnshp.,* 277 F.3d 1361 (Fed. Cir. 2002).

On remand from the Federal Circuit, the district court in Nevada found that Lemelson's 18 to 39 year delay was unreasonable and unjustified, and that the claims of the 14 patents were thus unenforceable. In reaching this conclusion, the district court noted that by 1987, every claim that Lemelson had applied for in his 1972 application had issued as a patent. The court relied upon the following "combination of factors" as requiring a bar under the doctrine of prosecution laches:

(1) Mr. Lemelson's original disclosures were made public in the 1960s and those patents expired by the early 1980s;

(2) before the asserted claims were filed numerous articles and patents describing machine vision and bar code scanning were published, and commercial products were developed and marketed;

(3) Mr. Lemelson was aware of the developments in the machine vision and bar code fields, and yet he still waited;

(4) Mr. Lemelson systematically extended the pendency of his applications by sitting on his rights, and sequentially filing one application at a time so that he could maintain copendency while waiting for viable commercial systems to be designed and marketed; and,

(5) Mr. Lemelson (and his new counsel) then drafted and prosecuted hundreds of new claims in the late 1980s and 1990s specifically worded to cover those commercial systems.

. . . the plaintiffs asserted that Lemelson's delay of from 18 to 39 years in filing the applications that issued as the 14 patents-in-suit required a finding that the doctrine of prosecution laches barred enforcement of the patents.

The court also noted that some of the claims asserted by Lemelson will not expire until 2011, 55 years after the 1956 application was filed and 48 years after that application issued as a patent. Finally, the court held that intervening public and private rights – in the form of products designed and developed by the plaintiffs and various third parties – made prosecution laches applicable in this instance.

Claim Construction/ Infringement

In addition to the holding regarding prosecution laches, the court went on to construe certain contested claim terms and found that none of the plaintiffs' products infringed the patents. Specifically, the court agreed with plaintiffs' experts regarding the issue of "pre-positioning." According to the court, "in order to practice Lemelson's invention, the patents-in-suit require that the object being scanned must be 'pre-positioned' – that is located at a known distance, location and orientation – relative to the camera." Because none of plaintiffs' products require its bar code reader "to be pre-positioned at a known distance or aligned at a fixed attitude relative to a bar code," the court held that there was no infringement.[2]

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Lack of Enablement

Finally, the court addressed plaintiffs' invalidity arguments. The court concluded that all of the patents-in-suit were invalid for failing to comply with the enablement requirement of 35 U.S.C. § 112, ¶ 1. That section of the statute requires an applicant for a patent to provide a specification that contains "a written description of the invention, and of the manner and process of making and using it, in such full, clear, concise and exact terms as to enable any person skilled in the art to which it pertains, or with which it is most nearly connected, to make and use the same. . ." 35 U.S.C. § 112, ¶ 1.

Plaintiffs contended that no one had had ever built a "Lemelson system" because no one could do so. Lemelson's own experts conceded that a person of ordinary skill in the art – in this case, "an electronic engineer with about two years experience in signal processing and television electronics" – could not practice the inventions claimed in the patents. Accordingly, the court held the patents invalid for failing to provide an enabling disclosure.

What Happens Now?

This decision is somewhat historic in the sense that "Corporate America" has been fighting against Lemelson patents for almost 20 years, and finally some of those patents have been found unenforceable due to prosecution laches and invalid for failing to provide an enabling disclosure. But the battle is far from over. Lemelson has already indicated that it will appeal the decision, so we will have to wait for the Federal Circuit to finally decide many of these issues.

Moreover, even if the Federal Circuit affirms the district court decision, the decision may be "too little, too late" for many companies that have already entered into fully paid-up licenses with Lemelson. Most of these license agreements do not provide for any type of refund or discount in the event that any licensed patent is finally found invalid or unenforceable.

For those companies that have entered into a license agreement and have on-going royalty payment obligations, there is some hope. Those agreements should be reviewed to see what happens to the payment obligations in the event of an unenforceability or invalidity finding as to one or more patents. While it is possible that certain obligations may cease in this event, the obligation to pay may continue even if there is only one licensed patent that continues in full force and effect, regardless of the status of the remaining patents. •

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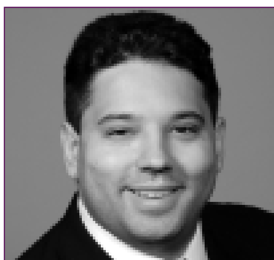
[1] While the court's one page Judgment included with the Findings of Fact and Conclusions of Law states that "the claims are invalid for lack of written description and enablement even if construed in the manner urged by Lemelson…", the court specifically refused to consider the written description issue in its findings. The court found "it unnecessary to consider whether the Lemelson specification contains a viable written description of the invention as required by [35 U.S.C.] § 112, ¶ 1." Accordingly, it appears that the enablement requirement comprised the only grounds upon which the court found the patents invalid.

[2] The court also construed other terms and found that plaintiffs' products did not infringe the patents based on those constructions as well.

Top 10 Mistakes in License Agreements

by Adam Petravicius



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He received his bachelor's degree in Electrical Engineering from the University of Michigan, magna cum laude *and graduated* magna cum laude *from Harvard Law School.*

This article identifies what the author believes to be the ten most significant mistakes made by parties – both licensors and licensees – when entering into license agreements. These mistakes are not just made by the novice negotiators or companies entering their first license agreement. Rather, these mistakes are routinely made by experienced practitioners as well as companies with sophisticated licensing programs.

#10 – Not Conducting Due Diligence

Parties frequently enter into significant license agreements without conducting appropriate due diligence. Yet the failure to do so often exposes them to serious risk of loss or liability. Before entering into license agreements, parties should undertake reasonable business and legal due diligence.

In many cases, parties mistakenly assume that the risks associated with due diligence will be adequately addressed by the terms of the license agreement. For example, license agreements often contain a warranty that the licensor owns title to the licensed intellectual property. However, most license agreements also contain numerous provisions that limit the parties' liability to each other, such as a limitation of liability provision and an exclusion of consequential damages provision (see below, #6 – Gambling on Liability). These provisions may significantly limit the remedies available to the licensee in the example above, even though the licensee may suffer great losses as a result of the licensor not having title to the licensed intellectual property (*e.g.*, because the licensee is forced to remove the licensed intellectual property from its product line).

Even if full recovery is allowed under a license agreement, it may be difficult or impossible to measure the amount of damages suffered by a party (*e.g.*, loss of market lead time). In addition, the other party may not have sufficient resources to allow full recovery by the damaged party. Finally, the cost of recovery (both in terms of time and resources) may make recovery impractical.

In each case, appropriate due diligence may enable a party to avoid — or address upfront — risks for which it will not have an adequate remedy under the license agreement. When determining the scope of diligence warranted by a license agreement, parties should consider both the potential liabilities (*e.g.*, third-party suits for infringement) and potential losses (*e.g.*, loss of licensed rights or license revenue) that may result from the license agreement. In addition, parties should consider their ability to recover any such liabilities or losses under the terms of the license agreement.

The following are some examples of areas that are commonly addressed by a licensee during due diligence:

- The licensor's ownership of, or license rights to, the licensed intellectual property.

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- Sufficiency and value of the licensed intellectual property with respect to the licensee's intended use.
- Validity and enforceability of the licensed intellectual property.
- Potential third-party claims relating to the licensed intellectual property (including potential infringement claims resulting from the licensee's use thereof).
- The licensor's ability to perform ongoing obligations (*e.g.*, software maintenance) and satisfy claims made by the licensee under the license agreement.

Most parties assume that due diligence is conducted primarily for the benefit of licensees. While this is correct in many cases, licensors may also benefit from due diligence. The following are some examples of areas that a licensor may wish to address during due diligence:

- The credit-worthiness of a licensee that is obligated to pay royalties.
- The licensee's ability to exploit the licensed intellectual property and, as a result, generate royalties.
- In the case of a trademark license, the potential product liability exposure that may be created by the licensee's use of the licensed trademark (especially if the licensee may have insufficient resources to indemnify the licensor for any product liability claims).
- The licensee's ability to perform ongoing obligations and to satisfy claims made by the licensor under the license agreement.

#9 – Ignoring Legal Framework

License agreements are a type of contract, and are governed by the same rules that apply to contracts in general. However, there are many legal rules that are unique to license agreements. There are also many other legal rules that, although not unique to license agreements, frequently arise in the context of license agreements. By failing to consider these rules when entering into license agreements, parties may risk losing significant license rights or exposing themselves to significant liability. When entering into license agreements, parties should seek advice of counsel familiar with the rules applicable to license agreements.

A significant example of a legal rule unique to license agreements is the doctrine of patent misuse. Put simply, the doctrine of patent misuse applies to a patent owner's attempt to misuse its patent rights by attempting to expand the scope or duration of its patent rights. The most common examples of patent misuse are tying the grant of a patent license to the purchase of an unpatented product or extending the payment of royalties beyond the patent term. A successful claim of patent misuse may render a patent ***unenforceable***. Patent misuse claims are often based upon the terms of a license agreement, but can also be based upon the conduct of the licensor during license negotiations. In fact, many patent misuse claims are brought by licensees seeking to escape paying royalties.[1]

A significant example of a legal rule that is not unique to license agreements but that frequently arises in the context of license agreements are the antitrust laws. Many parties fail to realize that there is no "safe harbor" under the antitrust laws for the licensing of intellectual property. Even though the ownership of intellectual property essentially confers a type of legal monopoly upon the owner of such intellectual property, the manner in which the owner exploits such intellectual property is still subject to scrutiny under the antitrust laws.[2] In fact, certain exclusive licenses valued in excess of $50 million may be subject to the reporting requirements of the Hart-Scott-Rodino Act.[3]

Another example of this type of rule are the rules and regulations pertaining to the export of technology from the U.S. When entering into license agreements with foreign entities, parties need to understand and comply with these rules and regulations. Even when entering into a license agreement with a U.S. entity, parties should be aware that the disclosure of certain technology to a citizen of another country may constitute an export of such technology.

#8 – Creating Terminal Confusion

Many license agreements contain unclear term and termination provisions. In many cases, the lack of clarity results from conflicting terms in the license agreement. In other cases, it is caused by poor drafting of the relevant provisions. Each license agreement should clearly define the term of the license, any events that may trigger termination of the license and the effects of any expiration or termination of the license agreement.

A common example of contradictory provisions is when the license grant characterizes itself as being "perpetual" or "irrevocable" but the termination provision states that all licenses granted under the agreement "automatically terminate" upon expiration or termination of the license agreement. A variation of this example is when the license grant again characterizes itself as being "perpetual" or "irrevocable" but there is a separate provision defining the term of the license agreement as some finite period (especially, as in many cases, when this provision makes reference to any licenses granted under the license agreement). Another common example is a license grant that expressly states that the license remains in effect only during the term of the license agreement coupled with a survival provision that provides for survival of the license after expiration or termination.

To avoid confusion, a license agreement should have a single provision that addresses the duration of the license. Ideally, this provision will be separate and apart from the license grant itself, and the license grant will make no attempt to define its duration (*e.g.*, through the use of words such as "perpetual"). This provision should clearly specify the expected duration of the license and should also specify any conditions under which the duration of the license can be extended, and for how long. If the license agreement includes other rights or obligations in addition to pure license terms (*e.g.*, maintenance obligations or other services to be provided), this provision should specify whether the license has the same or different duration as the other rights or obligations.

The license agreement should also clearly define any events that may lead to early termination of the license (*i.e.*, termination triggers). Again, these events should be collected in a single provision that, ideally, is in close proximity to the provision defining the term of the license. For example, a common termination trigger is a material breach of the license agreement that remains uncured for a specified time period. There are many other possible termination triggers (*e.g.*, termination for convenience, failure to meet milestones or failure to make minimum royalty payments) and identifying them is beyond the scope of this article. Whatever termination triggers are used, parties to a license agreement should avoid the common practice of sprinkling the applicable termination triggers throughout the license agreement and instead collect them in a single provision. Alternatively, if a license agreement is drafted to include termination triggers in several locations, the license agreement should include a single provision that cross-references all of the termination triggers throughout the agreement. In this case, additional care will need to be taken to ensure consistency throughout the various termination triggers.

A license agreement should expressly address the effect of

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expiration or termination on any existing license rights or obligations. Again, if the license agreement includes rights or obligations in addition to pure license terms, the license terms should be distinguished from the other rights or obligations. The effect of termination is most commonly handled through a separate "survival" provision that states that certain specified provisions of the license agreement survive expiration or termination. However, most "survival" provisions are nothing more than a laundry list of section numbers that are purported to survive, without regard for the reason that the license agreement has expired or terminated. Parties should exercise care in listing the surviving provisions in order to avoid confusion, and where appropriate should provide an explanation as to how and why a particular provision survives. In many cases, the surviving provisions may vary based upon the reason for the license agreements expiration or termination.

The parties may also wish to include additional rights or obligations that are triggered as a result of expiration or termination of the license agreement. For example, a license agreement involving trade secrets may require a licensee to return or destroy all copies of such trade secrets upon expiration or termination. Again, the additional rights or obligations may vary based upon the reason for expiration or termination. For example, if a software license is terminated due to the breach of the licensor, the licensee may obtain the right to use the source code for the licensed software.

Finally, there are a few common misconceptions regarding termination triggers that are worth mentioning:

Many parties assume that use of licensed intellectual property outside of the scope of a license grant is a breach of the license grant, and therefore may give rise to termination (assuming it is a material breach and material breach is a termination trigger). However, this may ***not*** be a breach of the license grant unless there is an ***express negative covenant*** stating that the licensee will not use the licensed intellectual property other than as permitted by the license grant. Rather, the unpermitted use would amount to an infringement by the licensee.

Most license agreements include language along the lines that the agreement can be terminated if a party files for bankruptcy. As a general rule, however, these termination triggers are unenforceable under the bankruptcy laws as *ipso facto* clauses (which refers to clauses that are triggered by the occurrence of bankruptcy). Parties should avoid relying on termination provisions that are triggered by bankruptcy and instead use provisions that are tied to relevant performance obligations (*e.g.*, the failure to provide maintenance or pay royalties) or other relevant measures.

Many license agreements purport to be perpetual in duration, and the parties to such license agreements often intend for the license to last forever. However, the law in many states disfavors contracts of perpetual or indefinite duration for public policy reasons. As a result, certain states may interpret a "perpetual" license as being terminable at will by either party. If the parties truly intend to create a perpetual license, the license will need to be structured in a manner that avoids this interpretation.

#7 – Exposing Secrets

License agreements often involve an exchange of trade secrets or confidential information, even if it is not the primary purpose of the agreement. Yet many of these license agreements contain inadequate provisions regarding confidentiality. Even more importantly, parties to license agreements often rely solely on contract rights to protect their information and fail to take other essential steps to do so. Parties

should carefully review confidentiality provisions to ensure their adequacy, and should consider taking additional steps to protect sensitive information.

Most license agreements involving the exchange of trade secrets or confidential information include some form of a confidentiality provision. However, the parties often fail to tailor the confidentiality provision to the deal at hand and instead rely on a so-called "standard" provision. There is no such thing as a "standard" provision that works for all deals and reliance on a "standard" provision can lead to significant losses or liabilities.

Each party should carefully review any confidentiality provisions to ensure that they are appropriate to the deal from its perspective. The following are examples of issues that should be considered:

The parties should consider the scope of information to be protected. When doing so, the parties should balance the need to protect information against the risk of being over-exposed to (and possibly tainted by) the confidential information of the other party.

The parties should consider defining specifically how confidential information may be used under the agreement. In doing so, parties should avoid using language that allows any use "permitted by the agreement" or "contemplated by the agreement" or any similar language, as this type of language is vague and open to differing interpretations by the parties.

The parties should consider defining specifically how confidential information should be protected under the agreement. Many agreements require the parties to protect information using the same degree of care as they use for their own information, but in no event less than a reasonable degree of care. Although this language may be sufficient in many cases, parties should consider identifying specific measures to be taken to protect confidential information (such as placing information in a locked cabinet).

Parties should not rely solely on contract provisions to protect their sensitive information. Although appropriate confidentiality provisions are essential to protecting confidential information, they may not be sufficient in some cases. Detecting improper use or disclosure of confidential information may be difficult, and proving it in court may be even more difficult. Furthermore, seeking relief under a confidentiality provision may be akin to attempting to un-ring a bell. For example, a trade secret that is widely distributed on the Internet may forever lose its status as a trade secret and the available contract remedies may be inadequate to address the harm. As a result, companies should consider what additional measures they may take to protect their sensitive information. These measures may be as simple as being selective in the information to be disclosed or as complex as implementing sophisticated technological solutions to track and restrict the flow of its confidential information.[4]

#6 – Gambling on Liability

License agreement typically include several "liability provisions," which expressly allocate certain liabilities between the parties.[5] Despite the fact that claims relating to intellectual property can result in significant liabilities, and despite the fact that improper use of intellectual property can lead to significant losses, parties often fail to consider the liability provisions that allocate liability between them as carefully as they should. Parties should carefully analyze the impact of all liability provisions on the overall business case for a license agreement.

Liability provisions (along with a number of other provisions) are often given the misnomer of being a "legal issue." In contract negotiation lingo, a "legal issue" is an issue that is left to be addressed exclusively by the lawyers on the deal, and that is

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largely ignored by everyone else on the deal (except to the extent the lawyers cannot reach agreement regarding a legal issue, in which case the others will reluctantly listen to their lawyers' explanations and then prod them to resolve the issue). This is a misnomer because all contract terms – and especially liability terms – can have a significant impact on the business deal being negotiated.

Although lawyers certainly have significant knowledge and expertise regarding liability provisions, these provisions should be carefully considered by all of the persons responsible for negotiating the license agreement. When making the business case for a license agreement, the potential liabilities and losses, as well as the allocation of risk between the parties, must be factored into the analysis in order for the analysis to be meaningful. In other words, the liability provisions must allocate risk between the parties in a manner that is consistent with the overall business case for each party.

When crafting liability provisions, parties should balance the need to limit exposure to liability against the need for meaningful remedies. For example, most license agreements include a provision that states that neither party is liable for consequential damages. However, in many claims involving intellectual property licenses, consequential damages may make up most of the damages suffered by a party. If consequential damages are excluded, then the damaged party may not have a meaningful remedy available to it. Some license agreements attempt to fix this problem by creating exceptions to these types of exclusions or limitations (*e.g.*, an agreement may state that the exclusion of consequential damages does not apply to a breach of the confidentiality provisions). While this solution provides a meaningful remedy to the damaged party, it may go too far the other way by exposing the other party to unlimited consequential damages.

One specific issue worth mentioning here is to avoid creating an indemnity provision that "short circuits" other liability provisions in the agreement. A "short circuit" is created if an indemnity provision allows a party to pursue a claim for breach of contract that bypasses the liability provisions that would normally apply to a breach of contract claim. This situation generally arises when an indemnity provision is not limited to third-party claims (*i.e.*, it allows a party to make a claim for its own damages as opposed to damages suffered by a third party but for which it may be responsible). Many agreements carve-out indemnity provisions from liability provisions such as limitations of liability and exclusions of consequential damages. Therefore, if a party is able to make a claim for its own damages under an indemnity provision, it may be able to bypass or "short circuit" the limitation of liability and exclusion of consequential damages provisions that would have otherwise been applicable to its claim.

#5 – Not Watching the Money

Many significant disputes in license agreements are caused by unclear royalty provisions. Although parties typically spend a lot of time thinking about and discussing royalty payments, their discussions are often poorly documented in the license agreement. It is essential for parties to carefully document the royalty provisions in a license agreement in a manner that avoids uncertainty regarding the application of those provisions.

A primary reason for this poor documentation is that discussions regarding royalties often take place outside of the contract drafting process (*e.g.*, beforehand or as a separate ongoing discussion). The royalty discussions often use spreadsheets, charts or other similar means to capture the agreed-upon royalties. The results of the royalty discussions – in whatever form they may be – must

then be translated to contract language for inclusion in the license agreement. In many cases, something important gets lost in the translation.

To avoid this translation error, the person primarily responsible for drafting the contract language should participate in all key discussions regarding royalties and should fully understand all aspects of the agreed-upon royalty structure, including any assumptions made by the parties. Similarly, the person primarily responsible for determining the royalty structure should carefully review the contract language to ensure that it captures all aspects of the agreed-upon royalty structure, with the understanding that the contract language stands by itself (and all prior discussions, spreadsheets, etc. are irrelevant). In doing so, this person should test the contract language against all likely scenarios and all key assumptions and verify that it addresses them correctly. In addition, this person should test the contract language against a few unlikely (but possible) scenarios to see how it handles them.

Another tactic that may be employed is to include in the contract language one or more sample calculations, which should be chosen to illustrate a range of possible scenarios. The sample calculations should not be used as a substitute for well-drafted contract language defining the royalty payments, but rather should illustrate the correct interpretation of the contract language and correct application of such language to real-world examples.

Even where parties carefully document their intended royalty structure, disputes often arise due to the parties' failure to address certain scenarios. These disputes are most common where the royalty is a percentage amount. For example, a royalty provision may require a five percent royalty on the gross sales of a licensed invention. Calculating the royalty amount may be a trivial exercise if the licensed invention is sold as an individual item, but could be very difficult if the licensed invention is bundled and sold together with other items (*i.e.*, no price is established for the licensed invention on an individual basis). If the royalty provision is silent regarding bundling, then the parties are likely to dispute how to calculate royalties on the bundled sale.

When dealing with percentage-based royalties, parties should carefully define how the base amount (against which the percentage is applied to calculate the royalty) should be determined. In doing so, the parties should attempt to address all of the scenarios under which the licensed item may be used or sold (*e.g.*, individual versus bundled sales as discussed above). The scenarios to be addressed will be unique for each license agreement, but often include one or more of the following:

- Sales to or through affiliates or related parties
- Bundled sales (*i.e.*, the licensed item is sold together with other items for a single price)
- Component sales (*i.e.*, the licensed item is sold as a component of a larger item for a single price)
- Discounted sales (especially if the licensee may derive some other benefit in exchange for giving a discount)

In addition, if the royalty is based upon "net sales" then the parties should expressly address what may be deducted from "gross sales."

A tactic that may be used by licensors to mitigate the risk of a poorly-defined royalty provision is to include a provision that requires payment of a specified minimum royalty on either an individual sale (or other royalty-triggering event) or on an aggregate basis, or both. Licensees faced with a minimum royalty provision should expressly address the consequences of failing to meet the minimum royalty (*e.g.*, whether the licensee is obligated to pay the minimum or has the option of doing so in order to avoid termination of the license).

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#4 – Missing the Next Next Thing

License agreements often fail to address improvements to licensed intellectual property, or address them inadequately. As a result, licensees may find themselves stuck with old technology (or other intellectual property) and licensors may find themselves giving away more than they intended. During negotiations, each party should consider the possibility of improvements made by either the licensor or the licensee. It may also make sense to investigate this issue during due diligence by either party (see above, #10 – Not Conducting Due Diligence). The parties should then expressly address improvements in the license agreement.

When addressing improvements in the license agreement, parties should avoid the temptation to simply add the word "improvement" to the license grant and other relevant provisions. Instead, the parties should carefully define what exactly is meant by the term "improvement." In particular, parties should consider whether the term "improvement" should be limited to literal improvements to licensed intellectual property or should instead include substitutes or next-generation technology or intellectual property.

The license agreement should clearly specify what rights and obligations, if any, the parties have with respect to any improvements. In doing so, licensees should focus on license terms that lock it into certain technology (or other intellectual property) that may become obsolete (*e.g.*, because of obligations to commercialize such technology or ongoing royalty payments). On the other hand, licensors should be wary of licensing future technology (or other intellectual property) before understanding the value and application of such technology (or other intellectual property).

Finally, the parties should recognize that it is not necessary to apply blindly the same license terms to improvements (such as the scope of license grant or royalty rates). In many cases, it may be preferable to create a mechanism for establishing these terms after the relevant improvement is known to both parties. For example, the license agreement may include a mechanism that obligates both parties to negotiate a royalty rate in good faith or may grant the licensee a right of first offer or right of first refusal for the improvement.

#3 – Forgetting about Practicalities

Many license agreements fail to address the mechanics of the deal or, if they do address the mechanics, they do so in an impractical manner. The person responsible for drafting the license agreement should understand how the key elements of the deal will be implemented and document them appropriately. This person should also verify that these implementations are practical under all likely circumstances.

A primary reason for not addressing deal mechanics in a contract is that parties believe that doing so amounts to "stating the obvious." However, parties should keep in mind when deciding how much documentation to include in a contract that "stating the obvious" in a contract is much easier – and nowhere near as costly – as fighting about what is "obvious" long after the contract is signed.

One example of failing to address deal mechanics is failing to consider where licensed technology resides and how it will be transferred from the licensor to licensee. Trade secrets often reside in the minds of the licensor's employees or are incorporated into the licensor's business processes. A license that purports to license such trade secrets may be useless to the licensee if the license agreement does not specify how those trade secrets will be conveyed from the licensor to the licensee (*e.g.*, through training or consulting by the licensor's employees).

Another example is failing to consider whether additional

materials are necessary for the licensee to take full advantage of the licensed rights. In the case of a patent license, it may be necessary for the licensee to have access to the licensor's know-how or detailed product specifications. In the case of a software license, it may be necessary for the licensee to have access to the licensor's proprietary tools for modifying and maintaining the software. In the case of a copyright license, it may be necessary for the licensee to have access to a master copy of the copyrighted material in an appropriate form. If the license agreement fails to address these additional materials, then the licensee may forego its right to have access to them.

A common example of an impractical solution are the source code escrow arrangements in many software licenses. To protect against the licensor's failure to maintain the licensed software, many software licenses require the licensor to place source code into escrow. However, the terms of the escrow arrangement are often impractical, making it impossible for the licensee to derive any benefit from the arrangement. For example, the time period between when the licensor first defaults on its obligations to when the licensee obtains access to the source code may be too long for the licensee's practical business needs (*e.g.*, the licensee may not be able to wait thirty days or longer while its mission-critical software remains inoperative). Then, after gaining access to the source code, the licensee may discover that the source code is woefully incomplete (and to compound the problem, the licensor may be going out of business or in bankruptcy). Finally, after gaining access to the source code, it may take the licensee's software personnel an even longer period of time to learn how to use the source code.

#2 – Poorly Defining Scope of License

One of the most important provisions in a license agreement is the provision that defines the scope of the license grant. Yet in many license agreements, the license grant is vague at best and completely unclear at worst. Parties should carefully review the license grant (again and again if necessary) to ensure that it clearly defines the scope of the license.

Somewhere along the way in the history of license agreements, drafters adopted the convention of defining the scope of a license, no matter how complex, in a single sentence, using as many clauses (and corresponding commas) as necessary to get the job done. This convention, combined with the inherent ambiguity in the English language, is the biggest culprit in creating unclear license grants. Another source of confusion is the related practice of combining all forms of intellectual property (*e.g.*, patents and trade secrets) into a single, garbled license grant that consists of a mish-mash of license rights relevant to each of the different forms of licensed intellectual property.

To avoid confusion in the license grant, parties should consider the following techniques:

- Use simple declarative statements instead of complex clauses to describe license rights.
- Make effective use of defined terms, that are defined outside of the license grant, to make the license grant easier to read and understand.
- Avoid lumping together different forms of intellectual property. Instead, include a separate license grant for each form of intellectual property.
- Reference statutory rights or other appropriate legal rights when defining the scope of a license. If possible, avoid superfluous language that has no statutory or other legal basis.
- Avoid contradictory terms in the license grant. For example, many license grants are described as "sole and exclusive" but a "sole" license is different from an "exclusive" license and the two are contradictory.

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- Consider supplemental or explanatory provisions to help define the scope of a license grant, especially if the license grant is complex. For example, consider using a separate provision to carve-out certain excluded rights instead of trying to address the carve-out in the license grant itself. Another possibility is to include express examples of activities that are allowed or prohibited by the license grant.

#1 – Failing to Address Future Business Changes

License agreements often have very long durations (*e.g.*, perpetual licenses or licenses for the life of a patent). Yet most license agreements contain terms and conditions that remain static for its duration, and that do not address potential changes in the business environment. When negotiating license agreements, parties should consider how changes in the business environment could affect fundamental deal points and consider whether to include provisions in the license agreement to address them.

It is impossible to identify here all of the aspects of the business environment that parties should consider and, in any case, the aspects will vary for each deal. However, the following are some aspects that are common to most license deals:

- Development of competing intellectual property (either in the form of improvements or substitutes).
- Market declines or business downturns.
- Mergers, acquisitions and divestitures.
- Changes in technology (*e.g.*, the widespread use of the Internet).

In some cases the parties may be able to anticipate specific changes to the business environment, in which case they should include express provisions to address those changes. In other cases, the parties may be unable to anticipate specific changes but still may be able to include a general process or mechanism to identify and then address fundamental changes to the business. •

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[1] *See, e.g., Brulotte v. Thys Company*, 379 U.S. 29 (1964); *Scheiber v. Dolby Laboratories, Inc.*, 293 F.3d 1014 (7th Cir. 2002).

[2] *See, e.g.*, "The 1995 Antitrust Guidelines for the Licensing of Intellectual Property," U.S. Dept. of Justice, Antitrust Division.

[3] 15 U.S.C. § 18a.

[4] For a detailed discussion of additional steps that parties may take to protect their confidential information, see the author's article entitled "Beyond the NDA: Digital Rights Management Isn't Just for Music," to be published in the January 2004 edition of the Intellectual Property & Technology Law Journal, published by Aspen Publishers.

[5] Examples of liability provisions include: (1) limitations of liability; (2) exclusions of consequential damages; (3) warranties and disclaimers of warranties; (4) exclusive remedies; (5) indemnities; and (6) force majeure provisions.

IP Counsel Notes

Marshall J. Schmitt led a discussion entitled, "From Discovery to Product" at the Techlaw Group's Spring International CLE Session on April 30, 2004 in Toronto. The discussion explored the legal steps that should be taken in bringing new discoveries to market in both the United States and Europe, particularly in the pharmaceutical industry. Jenner & Block is a member of the Techlaw Group, an international network of major law firms committed to serving the needs of businesses, institutions and individuals involved with technology.

Joseph F. Marinelli spoke at the Illinois State Bar Association's "Intellectual Property and the Classroom: Reading, Writing, Arithmetic and Litigation in the Internet Age" seminar held on March 5, 2004 in Chicago. Mr Marinelli co-led a panel entitled "Peer-to-Peer File Sharing," which discussed, among other things, on-campus file sharing and how to handle subpoenas and lawsuits based on peer-to-peer software use.

Reginald J. Hill served as a member of the faculty for the Minority Corporate Counsel Association's 3rd Annual CLE Expo, which was held on March 31 through April 2, 2004 in Chicago. Mr. Hill was part of a panel discussion on "IP Protection in Emerging Markets." Jenner & Block was the premier sponsor of the MCCA CLE Expo.

Mr. Hill will also be a faculty member at the *Corporate Legal Times* Superconference to be held June 22 and 23, 2004 in Chicago. Jenner & Block is an Alliance Partner sponsor of the event.

Donald R. Harris will speak at a Jenner & Block Executive Breakfast Briefing entitled "The Big Fix: Is the Patent Review and Enforcement Process Broken?" to be held at the Jenner & Block Conference Center in Chicago on June10, 2004. Mr. Harris will address recent changes proposed by the FTC to the current system of reviewing and enforcing patents.

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The practice includes attorneys who hold degrees in electrical engineering, mechanical engineering, physics, computer science, chemistry, biology/biochemistry, veterinary medicine and other technical fields, many of whom have been admitted to practice before the United States Patent and Trademark Office. Several attorneys had industry experience in their technical fields before their careers in the law, which better enables our attorneys to effectively and efficiently analyze the technical aspects of intellectual property and technology-related matters for the Firm's clients.

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