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ENFORCEMENT OF LICENSED INTELLECTUAL PROPERTY RIGHTS

by Jur. Dr Hans Henrik Lidgard¹

INTRODUCTION

Background

In the early 80s, nicotine gum made an impact as a smoking cessation device in the pharmaceutical industry. AB LEO of Helsingborg was the patentee, rapidly built a franchise with its Nicorette® trade mark and invested in research to improve the concept. Providing nicotine in a patch was soon under discussion. LEO was an expert in nicotine, but did not have a patch technology and therefore initiated discussions with a number of potential producers. Eventually LEO found a suitable partner, but the idea of creating a nicotine-patch had meanwhile been disclosed to several potential producers.

In the early 90s, the patch was developed, tested and ready for commercial launch and LEO was ready to grant rights to an interested US partner. LEO knew that it had to be cautious in making representations regarding the validity of the patent. The prospective US licensee likewise knew that other patents existed in the area and also that competitors had already initiated infringement proceedings against one another and that there was every reason to navigate carefully in dangerous waters. But because the patch was expected to help a large number of Americans stop smoking, the market was far too important to stay out of.

¹ The author is acting professor, active at the Lund University. This manuscript is still in a draft form and will be further amended.

In contrast to most deals I have been involved in, the parties in this case did not regard the infringement stipulations in the agreement as boiler-plate language. Even the businessmen were fully informed and aware of the need for caution.² The US partner embarked upon a due diligence study, which did not leave any stones unturned. The subsequent negotiation focused on the infringement provisions as much as any other commercial provision of the agreement.

Purpose

My purpose is not to present another case-report from an interesting commercial negotiation – even if I use the patch case as an illustration. Rather it is to investigate what rules of law affect responsibilities between a licensor and a licensee in infringement matters. There are two situations to be addressed. **The first** deals with responsibilities to take action against third parties infringing the licensed right. **In the second** the licensed right infringes third party rights. Having established an understanding of what the law is, the next goal is to determine whether the parties have an option to agree on other standards and, if so, what they should be. Finally I have checked whether there are risks that such agreements may be set aside by mandatory provisions of other types.

Certain limitations are called for. The licensing agreement is in focus. Even if the title refers to joint venture agreements, joint ownership agreements and the like, I do not believe that infringement situations are dealt with differently from one type of agreement to the other. The result should therefore be generally applicable.

Even if my approach is traditional legal research, I must confess that the study has not been free of problems. The licensing concept is different under different legal traditions and there is a lack of precise legal guidance. Case law determining the responsibility for infringement is rare and a study of doctrine regarding licensing serves up an abundance of "war-stories", in

² There was every reason to be careful, since the number of patents invalidated in legal proceedings is remarkable. Post-war investigations seem to confirm that more than 65% of patents litigated in US Courts of Appeal were ruled invalid. Likewise the situation in several European countries has been discouraging - even if not to the same extent. The figures are not indicative of the value of patent protection in general and only include those questionable patents which come under review. Sandgren, C., Patentlicenser. Studier i licensavtal angående patent, patentansökningar och know-how med särskild hänsyn till amerikansk och tysk rätt (with English summary). Akademisk avhandling, Norstedt (Stockholm) 1974, p. 225.

which practitioners share experiences from successful negotiations, but the amount of in-depth research is limited and sometimes outdated.

I approach matters in the following order: First comes an overview of what applies regarding responsibility for infringements in licensing agreements where the agreement itself does not contain any information. From this base, I discuss whether there is a need for agreement provisions. Different options for a balanced approach are considered and suggestions offered. The proposed solutions are checked against mandatory provisions. As a side-note I investigate whether there is a possibility to obtain insurance coverage for the responsibility of either party, which, of course, would be an elegant way of eliminating the problem.

WHO CARRIES RESPONSIBILITY IN CASE OF INFRINGEMENT - LACKING AGREEMENT BETWEEN THE PARTIES

Characterisation of the license agreement and the applicable law

In order to be able to address the need for and the content of infringement provisions in a license agreement there is a logical chain of events that must be penetrated. What is the nature of the license agreement, what rules should be applied in an international context to interpret the agreement of the parties, and what is the material law in the specific case. May the parties by agreement derogate from such provisions?

The license agreement

In a civil/common law perspective, the first stumbling block is the characterisation of the license agreement. Under civil law it is a common understanding that the rights-holder may either assign his entire property right or simply, through the license, grant a third party a right to operate under the industrial property rights.³ Under common law, the approach has traditionally been different. The license is a consent to the doing of acts that the patentee would otherwise be entitled to stop.⁴ The European Court of Justice (ECJ) has expressed itself in words which may entail either approach. It explains that the "specific subject matter" of a patent is to guarantee that the patentee has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time. The patentee can do this himself "or by the grant of licences to third parties." The right also includes "the right to oppose infringements."⁵

The two approaches indicate problems in characterising the license agreement. Is it an agreement that in the absence of precise national rules should be determined under ordinary rules of contract law and general purchasing obligations or is it an expression of IPR-principles that are subject to different rules?

Characteristic performance - still a discretionary approach in determining the law to apply

The characterisation of an international license agreement under conflict of law rules follows no precise pattern. Traditionally, European countries have opted for a balancing of connecting factors in order to determine where the centre of gravity lies in commercial relations. It is a flexible approach, leaving the judge to select the preponderant and decisive connecting factor

³ In Sweden e.g. Hedman, B., *Internationella licensavtal*, NIR 1969 p. 109, which expresses the traditional approach of granting a right. Sandgren p. 80 is more cautious in his survey of licensing and avoids a precise definition, discussing instead the purpose: *Licensavtalet är det rättsliga instrument, som används för att bringa tekniska, i vissa fall även ekonomiska, idéer, rön och erfarenheter i omlopp. ... tillverkningslicenstagarens syfte med avtalet i typfallet är att bli i stånd till varaktig aktivitet på det tekniska området ifråga samt kunna bedriva denna verksamhet under ekonomiskt gynnsamma betingelser.*" In Germany Stumpf, p. 5 defines "Lizensverträge, d.h. Verträge über die Einräumung von Benutzungs-, Herstellungs- und Vertriebsrechten ..."

⁴ White, T.A.B., *Patents for Inventions* (4th ed.) Stevens & Sons (London) 1974 at p. 358.

⁵ ECJ, Case 15/74, *Centrafarm BV et Adriaan de Peijper v Sterling Drug Inc.*, 31 October 1974, [1974] ECR 1147, [1974] 2 CMLR 480. See Haarala, S., *Patent- and Know-How Licensing in Europe*, NIR 1992 p. 305.

for determining the law applicable to the contract in each specific case among the various elements of the contract and the circumstances of the case.⁶

With the European Contracts Convention signed in Rome in 1980⁷ it could be expected that matters had been further addressed. There are, however, no specific provisions regarding licensing. Article 4 of the Convention stipulates the applicable law in the absence of choice:

1. To the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected ...

2. Subject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or ...

The concept of characteristic performance essentially links the contract to the social and economic environment of which it will form a part. The question remains how this statement should be interpreted in licensing situations. Is the characteristic performance the country where the licensee is entitled to exercise the right or is it connected instead to the licensor and the fact that he is abstaining from taking action? The question especially begs an answer in the situation where the license covers many countries and connecting factors are vague.

It has been suggested that it is *the performance for which the payment is due* that is determinative. The delivery of goods, the right to make use of an item of property, the provisions of a service etc. usually constitutes the centre of gravity and the socio-economic function of the contractual transaction. If the discussion is translated into activities between a principal and his middleman it should be the law of the country where the middleman exercises his activity which governs. This is translated into the law where the middleman has his principal place of business. To take the agency contract as an example, the characteristic performance being that of the

⁶ Giuliano, M., Lagarde, P., Report on the Convention on the Law Applicable to Contractual Obligations.

⁷ Convention on the law applicable to contractual obligations, opened for signature in Rome on June 19, 1980. (80/934/EEC) OJ 1980 L 266.

agent, the contract will be governed by the law where the agent has his principal place of business.⁸

That this interpretation should govern license agreements is, however, far from clear. An argument to the contrary could also be made. Plender suggests that the function of Article 4(2) is to give greater precision and predictability to the test required by Article 4(1). Where parties have not chosen the governing law and no choice of law is apparent from the circumstances of the case, it appears reasonable to presume that the contract is more closely connected with the law of the vendor's habitual residence than with that of the purchaser. A simple reason is that the pecuniary obligations of the purchaser are less likely to require supplementation by law. In contracts intended to transfer ownership, the characteristic performance is deemed to be that of the party who transfers ownership. In contracts intended to transfer the right to use a thing, the characteristic performance is again that of the transferor.⁹

In the end it appears that European conflict rules do not give a precise answer to what is the "characteristic performance" in licensing situations and it is unclear therefore what law has the closer connection. Judges will have a balancing discretion. There certainly is no fixed determining factor such as where the agreement has been entered into. It is difficult to see why the place where payment is to be made should be the most characteristic connecting factor. The characteristic purpose of the contract is to allow an activity in a specified territory in the interest of both parties. That appears a more refined analysis than focusing on payments and allowing the licensor a privileged position.

'Most significant relationship' governs in the USA

If the answer in Europe regarding applicable choice-of-law rules for licensing arrangements is uncertain, the situation is much the same in the USA. The Restatement Second¹⁰ principally calls for the application of the law of the place with the most significant relationship to the transaction and to the parties. Case law does not provide much guidance. Regarding joint

⁸ Giuliano-Lagarde A5.35-37. Such an interpretation appears consistent with the 1978 Draft Convention of the Hague Conference on Private International Law. The text provides that the law of the agent's business establishment is the applicable law.

⁹ Plender, R., *The European Contracts Convention*, (London), Sweet & Maxwell 1991, p 108-110 with further references.

¹⁰ Restatement Second *

ventures, two decisions focused on the purpose of the JV and applied the law of the place where venture was to operate.¹¹

This appears to lead in the same direction as the European Contracts Convention, but not in a systematic fashion. It is interesting to note that the standard Scoles & Hay digest on Conflicts of Laws in its more than 1000 pages is able to address the matter of conflicts without referring to licensing arrangements.¹²

National law will determine material responsibilities

No answer in general IPR-law

Industrial property rights legislation is generally not very outspoken regarding licensing arrangements. National IPR rules often confine themselves to clarifying that a rights-holder may license its rights to third parties and that such a license does not imply a right for the licensee to grant sub-licenses. Patent law too – in line with international conventions – stipulates terms and conditions for compulsory licensing.

The law is, however, silent with respect to the rights and obligations of either party. Yet, there is a substantial discussion in doctrine regarding what obligations may arise from the granting of a license. According to *Stumpf*, it is the duty of the licensor to enable the licensee to exercise the rights granted under the license agreement.¹³ This includes a duty to pay yearly renewal fees and other charges and to keep confidential information secret.

Even if the licensor in his capacity as patentee may intervene against an infringing third party, it appears to be a general consensus that industrial property rights legislation does not create such an obligation. Patent law has therefore generally in Civil Law countries empowered the exclusive licensee to take legal action against an infringer.¹⁴ In Sweden too a non-exclusive licensee may initiate infringement suits. If the German licensor abstains from intervening, this may be tantamount to a free license. Under the theory

¹¹ *Teas v. Kimball*, 257 F.2d 817, 823-24 (5th Cir. 1958) and *Flammia v. Mite Corp.*, 401 F.Supp. 1121, 1126 (E:D:N:Y: 1975).*

¹² Scoles, E., Hay, P., *Conflicts of Laws*, West Publishing Co (St Paul) 1982.

¹³ Stumpf, H., *Der Lizenzvertrag*, (5. Auflage), Verlagsgesellschaft Recht und Wirtschaft mbH (Heidelberg) 1984 at p. 155.

¹⁴ Stumpf, p. 198.

of most favoured treatment, the non-exclusive licensee may in such situations seek a reduction of his own royalty obligation¹⁵ or even damages from the licensor – especially if the licensor has collected from the infringer.

No answer in general contract law

Lacking more specific IPR-answer, the question of how to interpret the respective rights and obligations in a licensing relation then becomes an exercise under general contract law. Is it the seller, as provider of services for remuneration who should guarantee that the service is free from both legal and material defects or is it the buyer who has a duty to verify what he is buying?

The Germanic perspective does impose a responsibility on the licensor to ensure that the licensed right at the time of the license is valid, technically feasible and actually possible to reduce to practice.¹⁶ These warranties do not, however, amount to guarantees regarding the industrial application or that the invention can be profitably practised. The licensor has a far-reaching duty to inform and the licensee has duty to inform himself and cannot invoke ignorance of facts he knew or should have known.¹⁷

Under German law a licensor does not, however, have a responsibility to pay annual fees, nor does he guarantee the future validity of the patent.¹⁸ Should the licensee determine that a patent is materially invalid, he may not for this reason stop paying royalties, but must obtain a court judgement to this effect.¹⁹ The result is that the buyer must dutifully scrutinise the object before purchase. Under European rules such a proposition comes naturally. A commercial buyer has an obligation to check the goods he is purchasing and, in ordinary cases, to perform under the license agreement unless there are specific guarantees – whether expressed or implied.

¹⁵ BGH, 29.4.1965, NJW 1965 p. 1861.*

¹⁶ BGB GRUR 1957, 595: Da der Lizenzvertrag als in der Regel gewagte Geschäft anzusehen ist, trifft den Lizenzgeber oder Verkäufer eine Haftung für den zukünftigen Bestand des Patentes im Zweifel nicht.* Compare BGB GRUR 1961, 468.*

¹⁷ Sandgren p. 284.

¹⁸ Interestingly, older German case law seems to indicate a responsibility for the licensor to defend against third parties claiming the invalidity of the patent. RG Mitt. 1934, 315.*

¹⁹ BGB GRUR 1969, 677: "Der Lizenznehmer nimmt mithin, solange das Patent noch nicht rechtskräftig für nichtig erklärt oder versagt worden ist, an der durch das bereits entstandene Schutzrecht oder an der durch die Erfindung begründeten Vorstellung gegenüber den Wettbewerbern teil, und er bleibt deshalb grundsätzlich bis dahin auch verpflichtet, die für die Teilnahme an dieser Vorzugsstellung vereinbarten Lizenzgebühren zu bezahlen." Sandgren p. 290 with further references.

The Anglo-American approach to licenses, as I have already established, is first of all not that the license implies a granting of a right to do something, but rather that the rights-holder certifies that he will not use his rights against the licensee. This in itself reduces responsibility for the validity of the patent as against third parties. American case law appears to confirm that rules governing the interpretation of contracts do not include any warranty as to the validity of the patent.²⁰ The fact that the seller is charging remuneration for the license does not alter this effect. However, if the licensor in any way has guaranteed the validity of the patent, the situation will be different and ordinary contract law provisions apply.

A licensee must, before entering into a contract, dutifully investigate all aspects of the patent under license including the risk of future invalidity due to insufficiencies in the application procedure or conflicting third party rights. In fact, he may be bound to the agreed obligations to pay royalties until the patent has been declared invalid by a court of law. Case law seems to indicate that the licensee is not entitled to ask for a refund of royalties paid - at least not before he has made a public claim that the patent be invalidated.²¹ The licensee, since 1969,²² cannot be prevented from challenging the validity of the patent. He may therefore always initiate such a proceeding to obtain the desired ends. The room for lawyering to use additional arguments is substantial.²³ In an exclusive license it may be claimed that the exclusivity implicitly means a guarantee that no other person should have the possibility of using the technique and that shortcomings in this respect invalidate the contract.

In conclusion

Both under civil and common law the main theory appears to be that a licensee may very well find that he carries the responsibility for legal defects in the licensed object – at least which appear after the contract has been entered into. As a consequence he must take action or defend his interests at his own cost unless the agreement stipulates to the contrary. A clear recommendation would therefore be that the licensee must perform a reasonable due diligence investigation to avoid substantial risks or protect himself contractually. On the other hand, the situation is much too unclear for a licensor to simply rely on advantages under statutory provisions and he better look to contractual clarity.

²⁰ Sandgren p. 234-238.

²¹ Sandgren p. 272-279.

²² *Lear, Inc. v. Adkins*, 395 US 653 (1969).*

²³ The possibility to invoke a general "public policy" argument appears to exist. Sandgren p. 239.

SHIFTING RESPONSIBILITIES THROUGH AGREEMENTS BETWEEN THE PARTIES

The uncertainties established call for express and detailed provisions in the agreement outlining the rights and duties of the parties.

In the nicotine patch agreement, LEO had first of all to certify that it was the rightful owner of the relevant rights under license. LEO also had to warrant that it was not aware of any third party rights which could have limited the possibility of exploiting the rights at the time of agreement or subsequently.

LICENSOR hereby represents and warrants that patent applications are valid and subsisting patent applications which have been created and submitted in accordance with usual industry practices, that LICENSOR has the right to deal with them in accordance with this Agreement, that there are no liens, encumbrances or other claims against them, and that LICENSOR is not aware of any infringement of them.

From this basis, a licensee will have to take over and protect all future interest in the territory.

From the date of this Agreement, LICENSEE shall continue the patent application and patent maintenance process with respect to the Patents, defend the Patents against any infringement or claim of invalidity, prosecute all breaches of any property rights in the Patents by third parties, and bear all costs and expenses associated therewith.

In the patch agreement, the licensee was only prepared to give such an undertaking after a solid due diligence investigation which included the patent history, the existence of prior art and other factors which could have impacted on the continued validity of the patent. The prospective licensee also investigated activities of competitors in the field in order to fully understand relationships and potential conflicts. The amount of effort devoted to this investigation was considerable. Only based on a green light from its IPR- experts was the licensee prepared to make financial commitments and proceed with the agreement.

The position taken up to this point appears to be much in line with what would have been a distribution of rights and obligations under both common and civil law.

There could, however, also be arguments for trying to shift the balance of the agreement. Assume that the licensee has the stronger financial resources and is less eager to enter into the relationship. He will then not accept an arrangement where the licensor takes no responsibility for legal challenges to the licensed object. The due diligence had disclosed certain questionable areas in the nicotine patch field where companies such as Elan Corporation in Ireland and Ciba-Geigy of Switzerland had obtained parallel patent rights. LEO had to give specific undertakings with respect to them.

LICENSOR agrees to indemnify, defend and hold LICENSEE and its Affiliates harmless from and against any and all losses, damages, liabilities, settlement amounts, costs or expenses, including court costs and attorney fees arising out of or resulting from any claim (i) of infringements made by X or its Affiliates, or (ii) based upon any patent now owned or controlled by X or its Affiliates.

However, it may also be that the licensee requires a total shift of the balance of the agreement because he is not prepared to accept any responsibilities at all. The position may simply be that the licensor as seller must guarantee that what he is selling will serve its purpose.

THE LICENSED RIGHT IS INFRINGED BY THIRD PARTIES

In the described situation, the parties are deviating from ordinary standards of law and an explicit agreement is therefore called for.

The starting point must be that the parties agree to keep each other informed about any development in the market which may have an impact on their respective rights.

In the event that either party becomes aware that there is infringement on a substantial commercial scale by a third party of any patent covering the product hereunder, such party shall notify the other party to that effect.

Under the first alternative to be investigated, a third party is infringing or threatens to infringe the licensed right. The infringer may continue until stopped. A threatening letter has to be issued, followed by an infringement action.

Licensor agrees to take action

A possibility is that the licensor guarantees that he will always take action and he excludes any action by the licensee. Such an undertaking, of course, amounts to a substantial risk-taking. Not only does the licensor have to take whatever actions are reasonably required – and in certain situations such reasonableness standards are high. The licensor probably has to define in the agreement whether his undertaking amounts to the full protection of the licensee. In case of failure, such an undertaking could also include damages. If the licensor is not prepared to go this far, such an obligation should be expressly excluded or at least limited to the amounts received in royalties from the licensee or some other form of clear-cut limitation.

Licensee wishes to take action – has he got the right?

The situation in Europe and the USA differs with respect to whether the licensee has an automatic right under the patent to act against infringing third parties. Under various civil law regimes it is clear that an exclusive licensee is empowered within the field of the grant to act against a third party infringer.²⁴ Under Swedish law even a non-exclusive licensee may take legal action against an infringer.²⁵

Under US standards a licensee has no independent right to act under the licensed patent unless this has been expressly agreed to.²⁶

So long as LICENSEE remains the exclusive licensee of the Patent in the Territory, LICENSEE, to the extent permitted by law, shall have the right, under its own control and at its own expense, to prosecute any third party infringement of the Patents in the Territory. If required by law, LICENSOR shall permit any

²⁴ Sandgren p. 64 with references to French and German law.

²⁵ Swedish Patent Law, Patentlag (1967:837) §§ 57-58.

²⁶ *Waterman v. MacKenzie*, 138 U.S. 252 (1981).* Compare *Independent Wireless Telegraph Co. v. Radio Corporation of America*, 269 U.S. 459 (1926).*

action under this Section to be brought in its name, including being joined as a party-plaintiff, provided that LICENSEE shall hold LICENSOR harmless from, and indemnify LICENSOR against, any costs, expenses, or liability that LICENSOR incurs in connection with such action.

Prior to commencing any such action, LICENSEE shall consult with LICENSOR and shall consider the views of LICENSOR regarding the advisability of the proposed action and its effect on the public interest. LICENSEE shall not enter into any settlement, consent judgment, or other voluntary final disposition of any infringement action under this Section without the prior written consent of LICENSOR

Alternative solutions

Licensor will have a first option. If he does not act within a defined period, licensee may act.

Rarely do either party to the agreement wish to make a wide undertaking with unforeseeable consequences, but they may still wish to control the development. A licensor may then proscribe that he will take a first bite at the cake. He will take action within a reasonable period of time against any third party infringer. If he does not act, the licensee may undertake whatever action he sees fit. The parties will cover their own costs of such intervention and should also be entitled to retain any awards granted.

LICENSEE will cooperate fully with any action, which LICENSOR may take to defend the validity of any patent and prosecute any infringements thereof. LICENSOR shall assume any costs in such litigation and shall be entitled to any rewards or damages recovered.

In the event LICENSOR elects not to prosecute or defend any such action within a period of 60 days of LICENSEE's request, LICENSOR shall at the request of LICENSEE and as its sole obligation towards LICENSEE entitle LICENSEE to prosecute such action in its own name with LICENSOR's full cooperation. In such action by LICENSEE, LICENSEE shall pay all costs and expenses and shall be entitled to any profits or damages recovered. LICENSEE shall incur no liability to LICENSOR as a consequence of such litigation or any unfavorable decision resulting therefrom, including any decision holding LICENSOR's patent invalid or unenforceable.

Awards and royalties

Eventually the question will arise, what happens to any award obtained. The normal answer would be that the active partner retains any compensation, but if the parties have shared in the risk-taking they should also share in the financial outcome. Either solution must be stated.

Any recovery obtained in an action brought by LICENSEE shall be distributed as follows:

- (i) each party shall be reimbursed for any expenses incurred in the action,
- (ii) as to ordinary damages, LICENSEE shall receive an amount equal to its lost profits or a reasonable royalty on the infringing sales, or whichever measure of damages the court shall have applied, and LICENSEE shall pay to LICENSOR based upon such amount a reasonable approximation of the royalties and other amounts that LICENSEE would have paid to LICENSOR if LICENSEE had sold the infringing products, processes and services rather than the infringer, and
- (iii) as to special or punitive damages, the parties shall share equally in any award.

A further sensitive issue is what happens to ongoing obligations during the period the licensed right is infringed? The starting assumption is that royalties are due until the underlying patent has been declared invalid by a court or that the licensee has submitted a claim of invalidity.

From a licensee perspective there could be several objections to such a situation. The exclusive licensee is making payments based on being the sole entity entitled to exploit, which is not the case as long as the infringement continues. A common solution is to require that there be an interruption in payments during the period of infringement. If the licensor is to take action, the royalty level could reasonably be reduced. If the parties are to take joint action and especially if the licensee is fully responsible, moneys may be escrowed to cover future litigation costs.

LICENSEE may offset a total of fifty percent (50%) of any expenses incurred against any payments due to LICENSOR under this Agreement, provided that in no event shall such payments, when aggregated with any other offsets and credits allowed under this Agreement, be reduced by more than fifty percent (50%) in any reporting period.

THIRD PARTY CLAIMS THAT LICENSED RIGHT INFRINGES EXISTING RIGHTS

Licensee likely target

Apart from regulating how the parties should address infringements by third parties, they must also in their agreement consider responsibilities in case the licensed object should infringe third party rights.

Each party hereto shall notify the other party promptly in the event of the receipt of notice of any action, suit or claim alleging infringement by the manufacture, use or sale of the Product in the Territory of any patent, trade secret or other proprietary right held by a third party.

In an infringement suit instigated by a third party, plaintiff is likely to turn against the actual infringer – which normally would mean the licensee. The parties cannot in their license agreement alter this fact, but can undertake several dispositions, which will assist the licensee and reduce his burden.

LICENSOR warrants that it is presently unaware of any third party patent that contains claims that present, or any third party pending application which, if issued, would contain claims that would present, any issue of infringement by reason of the manufacture, use and/or sale of Product in the Territory. LICENSOR further agrees to make LICENSEE aware of such third party patents and applications promptly upon becoming aware of same.

The licensor may further empower the licensee to take action in his name, but could also keep the right to intervene and defend the rights – which in certain cases may be important for his overall patent strategy.

In the event that a declaratory judgment action is brought against LICENSOR or LICENSEE by a third party alleging invalidity, unenforceability, or non-infringement of the Patent, LICENSOR, at its option, shall have the right within twenty (20) days after commencement of such action to take over the sole defense of the action at its own expense. If LICENSOR does not exercise this

right, LICENSEE may take over the sole defense of the action at LICENSEE's sole expense.

Sharing of responsibilities

A further compromise is that the parties agree up-front that they are in the same boat and that they have a common interest in pursuing any defence. The advantage is obvious. Jointly they may pose a substantial threat to any third party, who may hesitate to meet two defendants in the court. The option may from this perspective look attractive, but it does entail the same type of problems as other 50/50 joint ventures. The parties must agree on each and every step in the litigation or entrust all decision-making to one or the other. What happens if they disagree on strategic issues, who instructs counsel, etc.?

Full agreement must also be secured on who carries what costs. To what extent will internal costs be calculated and allocated between the parties in a situation where one would do the bulk of the work and the other passively follows developments?

LICENSOR and LICENSEE shall be jointly responsible for defending any such action, suit or claim and equally share in the payment of all damages, costs (including any settlement costs and future payments) and expenses (including reasonable attorneys' fees) related thereto, provided, however, that any such attorneys with respect to which any reimbursement is being made are selected jointly by LICENSOR and LICENSEE (or are approved by the other party), that the party being sued shall control such defense, that the other party thereto is given the opportunity to participate in such defense and that no such action, suit or claim is settled without such other party's consent. LICENSOR and LICENSEE shall cooperate with each other in any such defense.

WILL THE AGREEMENT BE RESPECTED

IPR aspects of the agreement

As repeatedly underlined, national IPR provisions are silent as to the material obligations in a licensing contract. A few unimportant provisions regarding the right to grant sub-licenses are included in the Swedish Patent Act. Overall the situation is much the same for other IPR-rules and there are no specific rules covering the license arrangement with respect to distribution of responsibilities for infringements. The law therefore leaves it to the agreement of the parties and will not become an instrument controlling the final agreement.

Contractual aspects of a hardship clause

The terms of the agreement are instead governed by general contract law provisions. These are much too general to give any guidance as to who should shoulder the responsibility for infringements in a commercial license agreement. The only possible argument that may be made is that the clauses are actually "hardship clauses" which must be reasonably drafted to escape the risk of judicial modification.

On this note, I would like to add one specific feature, which relates to joint ownership of patents. Assume that the parties have agreed that they should jointly own patents developed by either of them under the contract. From a European perspective such joint ownership normally signifies that none of the parties can act with respect to such patents without the concurrence of the other.²⁷ Under common law the approach seems to be the reverse, either party is fully empowered to take legal action. This surprising difference calls for specific consideration in the licensing agreement.

²⁷ Lag (1904:48 s 1) om samäganderätt.

Competition aspects of infringement provisions

The group exemption for technology transfer agreements, the *Technology Transfer Regulation*,²⁸ specifically refers to infringement procedures in Article 2. It white-lists the obligation on the licensee to inform the licensor of third party infringements in the licensed patent or know-how. The obligation may either include the obligation to take legal action or to assist the licensor in his own action.

The regulation does not specifically cover the situation that the licensed patent is infringing a third party right. There is, however, no reason to assume that such a provision would take the agreement outside the group exemption. Generally, it could be held that competition is limited in the former case where the parties jointly and through the use of the licensed right try to prevent a third party from entering the market with his own product. If this provision is white-listed then there is no reason why a situation where the parties are trying to defend their right to be on the market should be regarded as an aggravating problem.²⁹ Such a provision would instead come under Article 2(2) of the Regulation, which provides that the exemption shall also apply where in an agreement the parties undertake obligations of the type referred to in paragraph 1 but with a more limited scope.

The group exemption has removed the proviso from the *Patent Regulation*³⁰ and the *Know-How Regulation*³¹ that the licensee must be

²⁸ Commission Regulation 240/96/EC of 31 January 1996 on the application of Article 85(3) of the Treaty to certain categories of technology transfer agreements (*Technology Transfer Regulation*), OJ 1996 L 31/2, [1996] 4 CMLR 405.

²⁹ Lidgard, H.H., *Licensavtal i EU*, Publica (Stockholm) 1997.

³⁰ Commission Regulation 2349/84/EEC of 23 July 1984 on the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements (*Patent Regulation*), OJ L 84/219, [1993] 4 CMLR 177. Article 2(1) provides that Article 1 shall apply notwithstanding the presence in particular of any of the following obligations, which are generally not restrictive of competition: (8) obligations: (a) to inform the licensor of infringements of the patent, (b) to take legal action against an infringer, (c) to assist the licensor in any legal action against an infringer, provided that these obligations are without prejudice to the licensee's right to challenge the validity of the licensed patent". For a brief comment, see Korah, V., *Patent Licensing and EEC Competition Rules Regulation 2349/84*, ESC Publishing Ltd (Oxford) 1985 at p.54.

³¹ Commission Regulation 556/89/EEC, of 30 November 1988 on the application of Article 85(3) of the Treaty to certain categories of Know-How Licensing Agreements (*Know-How Regulation*), OJ 1989 L 61/1, [1989] 4 CMLR 774 (replaced by Regulation 240/96/EC).

entitled to challenge the licensed property. This stipulation now appears in Art. 2(1)(15), but clarifies that if the licensee challenges the patent or secret know-how, the licensor will be entitled to terminate the agreement. Therefore, the contract could provide that:

If, at any time prior to the expiry by the effluxion of time of the last of the patent rights which make up the Patents, Licensee challenges the validity of the Patents or conducts itself in a manner inconsistent with the validity of the Patents, LICENSOR shall have the right to terminate this Agreement as though Licensee were in default of this Agreement.

Can insurance solve the problem?

Having established that the parties are exposed to substantial risks and that agreement on these aspects should be of primary concern, the question comes to mind whether it would be possible to obtain insurance coverage for the risks involved. If companies can insure themselves against third party product liability claims should it not be possible to insure oneself against the consequences of an invalid industrial property right. Coverage would be needed for damage claims and also for substantial procedural costs - primarily in the U.S.

The answer is that no major insurance company is presently offering such insurance and it is not likely that such insurance would be available.³² Damages can be regarded as a pure financial loss and insurance coverage is not available on this ground. Assuming that industry required such protection to a large extent insurers would of course design such protection. It requires, however, that risks can be properly assessed and distributed over a sufficient number of interested companies. At present there is no such demand.

A substantial part of patent proceedings is the litigation costs. Normally protection for such costs is available under ordinary liability insurance, but most insurance providers make special exceptions for patent litigation. Even if litigation costs were included, most insurance companies limit their responsibility geographically to the Nordic countries, which again would exclude protection in the country where it would be most desirable – the USA.

An elegant way of resolving the latter point is to ask the advice-rendering patent-law office to provide a legal opinion. Should this opinion prove

³² Discussion 990819 with Harald Ullman, Skandia, Stockholm.

wrong then indirect insurance protection through the consultant could be invoked. Whether consultants are keen on providing such risky opinions is another matter.

CONCLUSION

A general survey of national provisions is inconclusive as to responsibility for infringement actions. If anything, a licensor may be held responsible for transferring an unfettered right when entering into the agreement. The licensee, on the other hand, may well have to assume the risk thereafter.

The fundamental uncertainties call for clear and specific agreement provisions. There is no optimal way of structuring infringement provisions in a licensing agreement and there can be no standard, which covers all possible situations. Provisions must be tailor-made to fit the specific interests of the parties.

Considering these general remarks stemming from statutory provisions or practices, the parties should carefully lay out their contractual stipulations and pin-point their agreement. Generally, it can be expected that the parties will be prepared to support each other and especially convey information, which comes to their attention.

It becomes more problematic when the parties are making commitments which are hard to predict and where the actual risks involved could be substantial.

In the case of a third party infringing the licensed right it appears natural that the licensor, in his capacity as rights holder, takes the initiative. If he abstains, the licensee should be allowed to take over. The licensor may wish to clarify that the licensee shall have no other redress against him in case the infringement cannot be stopped. The licensee on the other hand could ask for reduced royalties – at least in an amount to cover his costs.

Equally important is to regulate the situation where a third party is claiming that his rights are infringed by the licensed object. He is normally expected to take the licensee to court and the latter therefore needs to protect himself in the license agreement. It may be reasonable to request that the licensor shares in the defence or that royalties are reduced or at least escrowed against costs involved. Again, the licensor may be interested in limiting his responsibility towards the licensee – perhaps to the amounts, which have been paid in royalty under the agreement. The type of damages

covered could exclude compensation towards the other party for loss of investments, future business opportunities or profits.

Finally, keep in mind that infringements may occur after the license agreement has been terminated and there may therefore be good reasons to ensure that the provisions survive the termination of the agreement.

INFRINGEMENT STIPULATIONS

General information & collaboration

In the event that either party becomes aware that there is infringement on a substantial commercial scale by a third party of any patent covering the product hereunder, such party shall notify the other party to that effect.

Each party hereto shall notify the other party promptly in the event of the receipt of notice of any action, suit or claim alleging infringement by the manufacture, use or sale of the Product in the Territory of any patent, trade secret or other proprietary right held by a third party.

Responsibilities distributed in line with the law

LICENSOR hereby represents and warrants that patent applications are valid and subsisting patent applications which have been created and submitted in accordance with usual industry practices, that LICENSOR has the right to deal with them in accordance with this Agreement, that there are no liens, encumbrances or other claims against them, and that LICENSOR is not aware of any infringement of them.

From the date of this Agreement, LICENSEE shall continue the patent application and patent maintenance process with respect to the Patents, defend the Patents against any infringement or claim of invalidity, prosecute all breaches of any property rights in the Patents by third parties, and bear all costs and expenses associated therewith.

LICENSOR agrees to indemnify, defend and hold LICENSEE and its Affiliates harmless from and against any and all losses, damages, liabilities, settlement amounts, costs or expenses, including court costs and attorney fees arising out of or resulting from any claim (i) of infringements made by X or its Affiliates, or (ii) based upon any patent now owned or controlled by X or its Affiliates.

Third Party is infringing the licensed right

Licensor to take action

LICENSEE will cooperate fully with any action, which LICENSOR may take to defend the validity of any patent and prosecute any infringements thereof. LICENSOR shall assume any costs in such litigation and shall be entitled to any rewards or damages recovered.

In the event LICENSOR elects not to prosecute or defend any such action within a period of 60 days of LICENSEES request, LICENSOR shall at the request of LICENSEE and as its sole obligation towards LICENSEE entitle LICENSEE to prosecute such action in its own name with LICENSORS full cooperation. In such action by LICENSEE, LICENSEE shall pay all costs and expenses and shall be entitled to any profits or damages recovered.

Licensee carries the responsibility

So long as LICENSEE remains the exclusive licensee of the Patent in the Territory, LICENSEE, to the extent permitted by law, shall have the right, under its own control and at its own expense, to prosecute any third party infringement of the Patents in the Territory.

Prior to commencing any such action, LICENSEE shall consult with LICENSOR and shall consider the views of LICENSOR regarding the advisability of the proposed action and its effect on the public interest.

LICENSEE shall not enter into any settlement, consent judgment, or other voluntary final disposition of any infringement action under this Section without the prior written consent of LICENSOR

LICENSEE may offset a total of fifty percent (50%) of any expenses incurred against any payments due to LICENSOR under this Agreement, provided that in no event shall such payments, when aggregated with any other offsets and credits allowed under this Agreement, be reduced by more than fifty percent (50%) in any reporting period.

Rewards and damages

Any recovery obtained in an action by Licensee shall be distributed as follows:

- (1) each party shall be reimbursed for any expenses incurred in the action,
- (2) as to ordinary damages, LICENSEE shall receive an amount equal to its lost profits or a reasonable royalty on the infringing sales, or whichever measure of damages the court shall have applied, and LICENSEE shall pay to LICENSOR based upon such amount a reasonable approximation of the royalties and other amounts that LICENSEE would have paid to LICENSOR if LICENSEE had sold the infringing products, processes and services rather than the infringer, and

- (3) as to special or punitive damages, the parties shall share equally in any award.

Licensed object infringing third party rights

Licensor responsible

LICENSOR warrants that it is presently unaware of any third party patent that contains claims that present, or any third party pending application which, if issued, would contain claims that would present, any issue of infringement by reason of the manufacture, use and/or sale of Product in the Territory.

Licensee takes over responsibility

If LICENSOR does not exercise this right, LICENSEE may take over the sole defense of the action at LICENSEES sole expense.

LICENSEE may offset a total of fifty percent (50%) of any expenses incurred against any payments due to LICENSOR under this Agreement, provided that in no event shall such payments, when aggregated with any other offsets and credits allowed under this Agreement, be reduced by more than fifty percent (50%) in any reporting period.

Joint defence

LICENSOR and LICENSEE shall be jointly responsible for defending any such action, suit or claim and equally share in the payment of all damages, costs (including any settlement costs and future payments) and expenses (including reasonable attorneys' fees) related thereto, provided, however,

that any such attorneys with respect to which any reimbursement is being made are selected jointly by LICENSOR and LICENSEE (or are approved by the other party),

that the party being sued shall control such defense, that the other party thereto is given the opportunity to participate in such defense

and that no such action, suit or claim is settled without such other party's consent. LICENSOR and LICENSEE shall cooperate with each other in any such defense.

Limitation

In no event shall any of the parties have claim for compensation towards the other party for loss of investments, future business opportunities or profits.

LICENSEE shall incur no liability to LICENSOR as a consequence of such

litigation or any unfavorable decision resulting therefrom, including any decision holding LICENSORS patent invalid or unenforceable.

Survival

This obligation shall survive the expiration or termination of this Agreement.