The Case for Arbitrating Intellectual Property Licensing Disputes

BY RICHARD H. SAYLER

Intellectual property, particularly the field of patent licensing, is rife with the potential for disputes. Litigation in this area has led to some of the most intractable and expensive court cases, some of which have lasted for 10 years or more. It is difficult to see any advantage to litigating these disputes. Instead, the author urges patent owners to seek faster and more economical means of enforcing their patent licenses. An experienced IP practitioner, he argues that arbitration is ideal, since it offers the parties a private process, a quicker and less costly resolution, and the ability to select experienced experts as arbitrators to resolve these disputes.

In my practice as a litigator in trials and appeals of IP matters, I have too often seen business executives with grand titles and egos blithely rely on such flimsy reasons in deciding to commit significant amounts of corporate dollars to long-lived IP litigation. Experience shows that it is simply unrealistic to expect decisions about IP—whether about licensing, cross-licensing, litigation or settlement—to be made solely on the basis of dispassionate, rational, economic analysis. So while you can be reasonably sure that the contract you enter into to buy a refrigerator at your local “big box” store will not end up in court, the same cannot be said about a contract to license IP.

Many patent licensing disputes over the last few years seem to involve licenses that cover substantially less than the whole term of the patent. These licenses may last for five or 10 years, and have built-in “trigger points” that call for earlier review of the parties’ relationship. This has led to increasing amounts of litigation. Indeed, litigation over the terms of IP licenses may come from unexpected quarters. Consider this “ripped from the headlines (à la “Law & Order”)” example.

A licensing professional for a company that designs and sells software to guard against personal computer (PC) viruses is asked to solve a problem. The problem is customers who share their evaluations of the company’s software with each other and the PC trade press. The licensing professional’s boss says that these bad evaluations are always out of date because they deal with problems that the company has already solved. The licensing professional...
saying he can fix the problem by adding a provision in the company’s license agreements prohibiting users of the licensed software from discussing its merits in any forum through which their views could be communicated to the public at large or any other third party. The company goes ahead with this proposed solution. Not surprisingly, the company is later served with legal process by the State Attorney General indicating his intention to ask a court to declare this contract provision void as against public policy because it violates the First Amendment.

It sounds silly for a company to solve its “unfair criticism” problem by prohibiting criticism as a matter of contract. But the example highlights a field in which there are many bright people who have worked their entire career within the confines of a narrow specialty who are either ignorant of the considerations and restraints that reside outside their area of specialization or have an exceedingly narrow-minded approach to their work.

The lesson of this tale is that anyone involved with licensing IP assets must develop a solid grasp of numerous legal and business considerations on a truly international scale. Another lesson, but from a different source, is the “Never Assume Anything” Principle. This still-sound advice was given to me more than 30 years ago by Chief Judge J. Edward Lumbard, my first mentor in the law. Over three decades, I have written a fair number of licensing or “joint venture” agreements and I have read even more of them. I have also litigated the meaning of many licensing provisions. From this I have learned that using standard form licenses and forms correspondence is a dangerous practice precisely because they were drafted based on a different set of facts, all or some of which are likely to be wrong for the current deal. By copying them, you erroneously assume that they can be used in your transaction.

Role of the Federal Circuit Court of Appeals in IP Litigation

Since its creation, the U.S. Court of Appeals for the Federal Circuit has in fact fulfilled one of its purposes—to speak with a single voice on important issues of patent law so that the rules governing the validity, enforceability, and infringement of patents do not vary from circuit to circuit as they sometimes did. The U.S. Supreme Court has contributed to this certainty as well, by promptly intervening to review controversial decisions made by the Federal Circuit in the exercise of its jurisdictional monopoly over all appeals from cases arising under the patent laws. The Supreme Court has been much more active in the patent field than it was in the several decades before the Federal Circuit was created.

Any case to enforce a patent or a patent license has the potential for attracting two common classes of counterclaims: (1) claims that the patentee may not enforce his rights because he is guilty of “patent misuse”; and (2) claims that the licensed patents are invalid, or unenforceable, or not in fact infringed by the licensee’s activities. As noted above, due to the Federal Circuit, the rules governing the second class of counterclaims are somewhat clearer and certainly more uniform today than in the past. The Federal Circuit is also responsible for acting decisively to limit essentially meritless charges of patent misuse. For example, it stated that, to be viable, a charge of patent misuse must focus only on the patents alleged to have been infringed and it must allege that those patents have been “impermissibly broadened” as to their physical or temporal scope “with anticompetitive effect.” See Virginia Panel Corp. v. Mac Panel Co., 133 F.3d 860 (Fed. Cir. 1997); Carter-Wallace, Inc. v. United States, 449 F.2d 1374 1384 (Ct. Cl. 1971). The Federal Circuit’s decisions have also made it clear that the anticompetitive effect requirement has substance, and that it is not satisfied by showing that a particular competitor somewhere lost money or bore some costs because of allegedly wrongful conduct by the patent owner. Rather, the term requires the type of showing that would have to be made in an antitrust case—i.e., that the alleged misuse caused competitive injury in a properly defined “relevant market.” And the court has not been shy about holding that only a few kinds of conduct can support either antitrust liability or a misuse attack on a patent owner’s assertion of his statutory right to prevent unauthorized infringement—such as deploying patents procured by deliberate and willful fraud, bringing “objectively baseless” infringement cases, or “tying” where there is both market power as to the tying product and an anticompetitive effect in the market for the tied product (with both markets properly defined, of course). See In re Independent Service Organizations Antitrust Litigation, 203 F.3d 1322 (Fed. Cir. 2000).

Under the line of cases expressing judicial solicitude for arbitration discussed above, all of these types of issues may be arbitrated to conclusion with very little concern that the courts will step in later to second-guess the result on “public policy” grounds.

—Richard Saylor
Advantages of Arbitration

These problems could be eliminated altogether by having an arbitration clause in the license agreement. An arbitration clause makes an arbitration hearing room (often in a lawyer’s office or a space provided by an ADR provider)—not a courtroom—the forum for resolving disputes that may arise.

Given the current law, it is a virtual certainty that an arbitration clause in a commercial agreement will be enforceable, and that any attempt by either party to circumvent that clause will be promptly rejected by a state or federal court, if asked to stay the arbitration or decide which issues in dispute are within the scope of the arbitration clause. Thirty years ago, one could not have said this. But since the 1970s, most courts—following the pro-arbitration teachings of the U.S. Supreme Court—have embraced arbitration as an acceptable and even preferred form of dispute resolution.

It is significant that the U.S. Court of Appeals for the Federal Circuit enforces arbitration clauses in patent disputes, even when the arbitrators did not perform the “claim construction” exactly like a court would have.

This judicial solicitude for arbitration has opened the door to arbitrating a wide variety of claims that formerly were considered to be non-arbitrable because they were imbued with a special public interest. That notion no longer exists. We have come 180 degrees since those days because today most securities disputes are required to be arbitrated, and it is quite clear that antitrust disputes, even those involving horizontal conspiracies, are arbitrable as well.

In addition, states have a limited ability to circumvent arbitration by statutory enactment. State power in this regard has been curbed ever since the Supreme Court showed that it is willing to use the Federal Arbitration Act to preempt state laws that frustrate or limit the issues that can be decided in arbitration.

As a result of a climate much in favor of commercial arbitration, some of the major technology companies are requiring their patent licensees to arbitrate all disputes arising from or related to their licenses. Why have they chosen to put an arbitration clause in their patent licenses? Probably because they know that arbitrators’ decisions are, for the most part, final and not likely to be second-guessed by the courts. More importantly, arbitration can afford the parties a fair amount of privacy (certainly more than can be attained in a public forum, like a court). The privacy of arbitration is a highly significant advantage. I have no doubt that some industrial “espionage” has been achieved by watching trials in public courtrooms.

In an arbitration clause, the parties can agree to keep the existence of the arbitration private, as well as to limit the disclosure of information in the arbitration. One IP arbitration clause I have seen even specified what the arbitrators could say in the award. It provided that the arbitrators’ order deciding a dispute could only specify how much one party owes the other, and could not go into any descriptive detail as to how that number was reached.

Since a patent licensee cannot be estopped by contractual boilerplate from challenging the validity of a licensed patent as a matter of public policy, IP owners should determine for themselves the most advantageous forum for the resolution of these disputes. In my mind that is arbitration. By requiring patent licensees to arbitrate, patent owners can prevent (or at least minimize) publication of adverse awards (such as those ruling that one or more of the licensed patents is invalid or was not infringed).

Thus, arbitration would be an especially good choice for an IP owner whose patents might be weak, or whose licensing restrictions might be both onerous and close to the ever-changing line of what is permissible under the antitrust laws or the “patent misuse” defense, assuming there is any difference between those bodies of law under the Federal Circuit’s current view.

In addition to privacy, there are, as many writers have pointed out, much better reasons for selecting arbitration as the means of resolving IP licensing disputes. Arbitration is inexpensive compared to the cost of patent litigation. It won’t take years to complete and it will produce a final and binding award, with limited potential for judicial review. The fact that there cannot be multiple trips to the appellate court minimizes the overall cost of resolving these kinds of disputes.

The most important advantage of arbitration, in my view, is the ability to choose the arbitrator—the individual who will decide the dispute. The right to select the arbitrator means that the parties can decide to select a person who has particular experience and/or expertise in certain fields, such as the law, science, technology, or business. Moreover, the parties can agree to have three knowledgeable and experienced arbitrators. For example, they might select two experts in patent law and one expert in the field of the patent. Obviously, having a panel of three arbitrators costs more, but it can be well worth it in a case with a lot at stake.

IP owners and licensees have many sources available to them to assist in the process of selecting the arbitrator. In arbitration administered by the American Arbitration Association, the AAA offers, as part of its case management services, access to arbitrators with experience in IP. Over the last 10 years the AAA has upgraded its panels and imposed rather rigorous continuing training requirements on the arbitrators who remain. Arbitrators on the AAA panel are not AAA employees. They are and have always been independent.
contractors with no involvement in the AAA’s marketing of its services. Importantly, the AAA has also established training requirements for its case managers. And several years ago it promulgated a Code of Ethics for its employees that it takes very seriously.

ADR providers also promulgate arbitration rules under which parties may conduct their arbitration. The AAA rules, when selected, apply unless the parties otherwise provide, so the parties can select the AAA rules and also tailor the process to their needs. For example, they can state how much discovery they would like (if they don’t, that issue will be left to the discretion of the arbitrators under the AAA rules). If the parties want the Federal Rules of Evidence and Civil Procedure to apply, they can so provide in their arbitration agreement, since ordinarily these rules do not apply in arbitration. Be aware, however, that selecting these rules may transform an arbitration process into litigation, lengthening the proceeding and increasing its cost.

In arbitration, the parties can (and should) specify the venue for the arbitration. This will avoid a rush to a courthouse in an unfriendly jurisdiction if a dispute arises during the term of the license. Despite arbitration’s economic and business advantages, some lawyers involved in IP are reluctant to agree to have an arbitration clause in IP licensing agreements. This places their clients at risk of a runaway jury verdict that may be difficult to eliminate on appeal. Some attorneys complain that arbitrators “split the baby” in their awards. But there is no evidence that this really happens; indeed, what little empirical evidence there is belies this belief. In my personal experience as an arbitrator, I have yet to see a 50-50 split award. The winners win. The losers lose.

Attorneys who prefer litigation because it offers full discovery and the opportunity for judicial oversight of this process should recognize that often there is no real benefit to judicially supervised discovery. Some judges and magistrates do it badly, and some “split the baby” to prove that they are fair. Even worse is the trend in some jurisdictions toward having local rules and case management plans that strictly limit the number of deposition hours and interrogatories, even for complex patent disputes.

My preference for including an arbitration clause in IP licensing contracts is strengthened by the ability I have as an attorney to address concerns about the process through careful craftsmanship of this clause.

**Conclusion**

IP licensing disputes seem to be inevitable. At the present time, the best way to achieve some control over the length of the dispute resolution process and its costs, as well as obtain a decision by individuals the parties respect, is to arbitrate. Although parties will sometimes be amenable to a post-dispute arbitration agreement, the only way to ensure that they will arbitrate IP licensing disputes is to provide for it in the licensing agreement when the deal is negotiated.

**ENDNOTES**


2 Flex-Foot Inc. v. CRP Inc., 238 F.3d 1362 (Fed. Cir. 2001) (affirming award).

3 JLM Indus. v. Stolt-Neilsen SA, 387 F.2d 163 (2d Cir. 2004).


