

## Development, Allocation and Management of IP

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In previous chapters we have largely focused on the licensing of existing intellectual property (IP) by a licensor to a licensee. But in many cases significant bodies of IP may be created by the parties during the term of the agreement. This IP may be created by a licensor who contracts to undertake technology development services for its licensee, or by a licensee that is given the right to make its own modifications and improvements to the licensed IP. Or, in some cases, IP may be developed jointly by the parties. In each of these cases, the parties must agree which of them will own the newly developed IP, and whether any licenses will be granted to the non-owning party, and how they will manage and prosecute that IP.

#### 9.1 LICENSEE DEVELOPMENTS: DERIVATIVES, IMPROVEMENTS AND GRANTBACKS

When a licensor provides IP to a licensee, the licensee is sometimes permitted to develop its own IP based on the licensed IP. This section discusses some of the legal issues surrounding those licensee-developed works, and how they are handled in IP licensing agreements.

##### 9.1.1 *Derivative Works and Improvements*

Section 101 of the Copyright Act defines a “derivative work” as

a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgment, condensation, or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions, annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship, is a “derivative work”.

Under Section 106 of the Copyright Act, the owner of a copyright has the *exclusive* right to prepare derivative works based upon a copyrighted work. Derivative works that are made without the licensor’s authorization have no copyright protection at all. Thus, if a licensee wishes

to prepare derivatives of any kind based on a licensed copyrighted work, it must be very sure to obtain the right to make those derivatives under its license to the original work.

The following case considers the degree to which a licensee obtains the right to prepare derivative works absent clear permission to do so.

### *Kennedy v. National Juvenile Detention Association*

187 F.3d 690 (7th Cir. 1999)

BAUER, CIRCUIT JUDGE

#### **I. Background**

On October 30, 1995, [Edwin] Kennedy and the [National Juvenile Detention Association (“NJDA”)] entered into an agreement for Kennedy to provide consulting services, to conduct a study of the juvenile justice requirements of the Seventh Judicial Circuit of Illinois (the “circuit”), and to submit a written report of his findings. The study was funded by the [Illinois Juvenile Justice Commission (“IJJC”)]. The goals of the study were to collect data regarding current juvenile detention practices, to recommend improvements in the juvenile detention process, and to estimate future juvenile detention requirements within the circuit. The contract was to run until September 30, 1996.

On September 20, 1996, Kennedy submitted a draft of his report to the NJDA. At the behest of the NJDA and IJJC, Kennedy made minor revisions to his report for no additional compensation. A few months later, the NJDA requested that Kennedy, in exchange for an additional \$10,000, make more revisions to his report because the original changes were not as extensive as they had hoped. Kennedy refused to make the revisions because he was concerned about compromising the integrity of his work, and he subsequently applied to register a copyright in his work. The copyright was effectively registered on January 13, 1997. In the meantime, the NJDA requested that Kennedy provide a disk with his copy of the final report. Thinking this was a condition for payment according to the agreement, Kennedy supplied the NJDA with the disk. When the contract had expired and Kennedy had refused to make further revisions to his report, the NJDA hired Craig Boersema to supervise the completion of the report. Kennedy was fully compensated for his completed work.

On January 17, 1997, Anne Studzinski, administrator of the IJJC, hosted a meeting in Chicago, attended by the NJDA’s Executive Director Earl Dunlap, and Boersema, for the purpose of altering Kennedy’s report; Kennedy neither knew of nor assented to the revision. Studzinski defended her revision of the report based on a clause in the contract which states:

Where activities supported by this contract produce original computer programs ... writing, sound recordings, pictorial reproductions, drawing or other graphical representations and works of any similar nature, the government has the right to use, duplicate and disclose, in whole or in part, such materials in any manner for any purpose whatsoever and have others do so. If the material is copyrightable, Edwin Kennedy may copyright such, but the government reserves a royalty-free non-exclusive and irreversible license to reproduce, publish, and use such materials in whole or in part and to authorize others to do so.

In March of 1997, Kennedy released his version of the report, and on April 1, 1997, Dunlap issued a press release discrediting Kennedy and his work in order to promote the revised version of the work. The NJDA published the official report in August of 1997.

Kennedy filed suit against the NJDA and IJJC for copyright infringement. The NJDA and IJJC filed motions to dismiss the claim based on lack of subject matter jurisdiction, lack of personal jurisdiction, improper venue, and failure to state a claim. The district court [granted] defendants' motions to dismiss for failure to state a claim, rejecting the other theories as well as the request for sanctions. [Kennedy appeals.] The NJDA re-asserts its contention that it had the right to produce derivative works from Kennedy's report or, in the alternative, that it had a right, as a joint author of the study, to publish its version of the report.

## II. Analysis

Kennedy concedes that the contractual agreement conferred upon the NJDA the right to reproduce and publish his report, however he argues that it did not grant either the NJDA or IJJC the right to create derivative works from it.

[The] district court found, and we agree, that the consulting agreement granted the NJDA a nonexclusive license to reproduce, publish, and use Kennedy's copyrighted report. The court also found that the term "use" must give the defendants rights beyond those of reproduction and publication. Moreover, it found that, considering the broad, comprehensive grant of authority given to the NJDA and IJJC, it was irrelevant that the agreement did not specifically refer to the defendants' right to create derivative works from Kennedy's copyrighted materials. Therefore, the district court found that the agreement gave the defendants permission to alter Kennedy's report and create a derivative work from it.

The NJDA suggests in its brief that the word "use" in this case is synonymous with "prepare derivative works." While we will not go so far as to agree with this interpretation, in the context of the consulting agreement between Kennedy and the NJDA, the term "use" does encompass the act of creating derivative works. To read the agreement any other way would render the term "use" superfluous. [A]s the contract stands, it grants the defendants the right to use Kennedy's report for any purpose whatsoever.

[AFFIRMED.]

MANION, CIRCUIT JUDGE, concurring in part and dissenting in part.

[T]he issue is whether "use," the third verb in the clause, unambiguously grants to the defendants the right to prepare derivative works. The other two verbs in this clause are unambiguous because they are statutory terms of art. But the drafters of the contract (the defendants) chose not to use the third term of art – "prepare derivative works." Instead they used the vague term "use." This suggests that the parties intended "use" to mean something other than simply "prepare derivative works." They may have intended it to mean something more than prepare derivative works or perhaps something less. It is very possible that they intended it to mean only prepare derivative works. But their intention is not clear from the contract's text, and so this term is "ambiguous." Thus the parties should be given the opportunity to create a record to show what meaning was intended, and doubts should be construed against the drafters to the extent doing so does not otherwise frustrate the intentions of the parties. Thus I would reverse the district court's dismissal.

## Notes and Questions

1. “Use.” In the Patent Act, “use” is one of the statutory exclusive rights granted to a patentee, but the term is not defined in the Copyright Act. Should copyright law look to patent law when the word “use” is employed in a copyright license? Or should general dictionary definitions apply? For example, *Webster’s New Collegiate Dictionary* defines the word “use” as “legal enjoyment of property that consists in its employment, occupation, exercise or practice.” Should a dictionary definition be controlling? What about normal usage of the term within the trade? What might “use” mean if not “prepare derivative works”?
2. *Derivative works and trade usage.* Though the parties in *Kennedy* may not have been very precise about the right to make derivative works, parties in industries that depend on the making of derivatives as their life’s blood (such as the literary and entertainment industries) are careful to delineate this right extremely carefully. How do you think that an agreement relating to the publication of a book, the translation of the book into another language, or the adaptation of a book for a film might address the issue of derivative works? Do you think that such agreements would simply grant a publisher or production company the right to “use” the licensed book?
3. *Improvements beyond copyright.* Questions regarding a licensee’s right to produce modified versions of a licensed work are not exclusive to the copyright licenses. Though the term “derivative work” is unique to the Copyright Act, patent and know-how licenses often address similar issues using the terminology of “improvements.” Thus, a licensee may be granted the right to make improvements to a licensed technology or may be expressly prohibited from doing so (though such a prohibition could run afoul of misuse and other rules, as we will see in [Chapter 24](#)). Trademark licensees are generally not permitted to create derivatives, modifications or improvements of the marks they are licensed. Why do you think this is the case?
4. *Ownership of improvements and derivatives.* Assuming that a licensee makes derivative works or improvements of a licensed work or technology, who owns such new works? Under US law there is a significant split between patent and copyright law in this regard. Under patent law, the inventor of an improvement to a patented invention will own that improvement, even though the improver may not be able to exploit that improvement without a license from the owner of the underlying (improved) invention. By the same token, the owner of the improved invention will have no right to use the patented improvement without a license from the improver. The patent on the improvement is thus called a “blocking patent.” Copyright law is different. Under Section 106 of the Copyright Act, a derivative of a copyrighted work may not be made without the authorization of the copyright owner. There is no copyright at all in an unauthorized derivative work – the derivative is simply in the public domain. Does this divergence between patent and copyright law make sense?<sup>1</sup> Which approach do you prefer?
5. *Derivatives abroad.* European copyright law generally treats derivatives of copyrighted works similarly to improvements of patented inventions – the creator owns them. Which system to you think is preferable – that of the United States or Europe?

<sup>1</sup> Judge Richard Posner offers a possible economic justification for the different treatment of improvements under patent and copyright law: technological improvement is typically a continuous, collaborative process, and allowing unauthorized improvers to patent their improvements encourages maximum participation in efforts to improve the originally patented process or product. Progress is much less pronounced in the arts; we do not think that after Shakespeare wrote each of his plays, other playwrights would have been well employed trying to improve them. Richard A. Posner, *Intellectual Property: The Law and Economics Approach*, 19 J. Econ. Persp. 57, 70 (2005).

## 9.1.2 Grantbacks

If a licensee of an IP right creates an authorized derivative or improvement based on that IP right, it will generally be owned by the licensee – its creator. But an IP licensing agreement can attach requirements to the ownership or licensing of that derivative work. At one extreme, the licensor of the original IP right can require that the licensee assign back to it all derivatives and improvements based on the originally licensed IP. Short of an assignment of ownership, a licensor can require that the licensee grant it a license to use and otherwise exploit such derivative works. Such a license running from a licensee back to the licensor is often called a “grantback” license.

In some cases, grantbacks can be royalty-free – simply treated as part of the consideration paid by the licensee for the original license grant from the licensor. In other cases, the grantback license may be subject to royalties at a rate negotiated at the time of the original grant or which will be negotiated once the derivative or improvement is made.

The following discussion of grantback clauses dates to 1975, but is still relevant today.

There are two principal reasons for the inclusion of grant-back clauses in patent licensing agreements. First, licensors who produce under their own patents or consider doing so may insist on a grantback clause to assure future access to improvement patents developed by their licensees. If the licensee develops a patentable improvement to the licensor’s patent and becomes the sole patentee under that improvement patent, he alone will be able to exploit the improved technology while the licensor may be left with an obsolete and useless process. A grant-back provision in the licensing agreement protects the licensor from this result. A patentee may prefer not to sell rights to his patent without the assurance that he will not be forced to compete with his licensees at a disadvantage.

Second, the parties may negotiate a grant-back arrangement to ensure unified control over an entire process. Just as a large undeveloped tract of urban land is more valuable than the sum of its constituent parts, an entire patented process is more valuable than the aggregate value of the component patents. The parties may, therefore, use grant-backs to maximize the overall efficiency of their relationship.<sup>2</sup>

## EXAMPLE: GRANTBACK

Licensee hereby grants to Licensor a nonexclusive [1], worldwide, royalty-free, paid-up, irrevocable, fully sublicensable right and license to [exploit all *rights* [2]] in and to any derivative works, modifications and improvements made by or for the Licensee that include or are based upon the Licensed IP (“Improvements”). Licensee shall notify Licensor of each such Improvement and shall deliver all such Improvements to Licensor within [three (3) business days] after they are made [3].

## DRAFTING NOTES

[1] *Exclusivity* – a grantback license may be exclusive or nonexclusive. An exclusive grantback requires the licensee to cede all rights in its improvements to the original licensor, a somewhat harsh requirement that would likely disincentivize the licensee from

<sup>2</sup> Richard Schmalbeck, *The Validity of Grant-Back Clauses in Patent Licensing Agreements*, 42 U. Chi. L. Rev. 733, 735 (1975).

making any improvements at all. If the licensor wishes to obtain exclusive rights to improvements, perhaps because it desires to incorporate all such improvements into later versions of its own products, the licensee could be permitted to retain a license to use its improvements internally, without the right to distribute them to others.

- [2] *Rights granted* – like any license, a grantback license must specify what rights are being granted. When considering this question, ask what the purpose of the grantback license is. Is it intended to enable the original licensor to incorporate the licensee's work into its own products? If so, the grantback license should be quite broad. Is it to enable the licensor to use the licensee's work in its own enterprise? If so, then the grantback license can be limited to internal use, and exclude the right to distribute further.
- [3] *Delivery* – a delivery obligation is often overlooked in grantback clauses, but it is important if the licensor has no way to know what developments the licensee is making with respect to the licensed IP. The timing of delivery may vary based on the type of technology or work being developed. A three-day delivery requirement is stringent, but could be important, for example, if the licensed IP relates to a vaccine technology that the licensee is testing for immediate use. If, on the other hand, the agreement relates to a film script or novel being translated into a foreign language, then delivery of the derivative work may be appropriate once completed, or a specified number of months after the license is granted.

### Notes and Questions

1. *Why grantbacks?* Why do you think that a licensor might insist on a grantback clause in an IP licensing agreement? What concerns might a licensee have with respect to agreeing to such a term?
2. *Grantbacks and antitrust.* Grantback licenses can be used by licensors to extend the scope of their IP rights, thereby stifling competition, and have thus been subject to scrutiny by antitrust enforcement agencies (see [Chapter 25](#)). In their 2017 *Antitrust Guidelines for the Licensing of Intellectual Property*, the US Department of Justice and Federal Trade Commission make the following observations about grantbacks:

Grantbacks can have procompetitive effects, especially if they are nonexclusive. Such arrangements provide a means for the licensee and the licensor to share risks and reward the licensor for making possible further innovation based on or informed by the licensed technology, and both of these benefits promote innovation in the first place and promote the subsequent licensing of the results of the innovation. Grantbacks may adversely affect competition, however, if they substantially reduce the licensee's incentives to engage in research and development and thereby limit rivalry.

A non-exclusive grantback allows the licensee to practice its technology and license it to others. Such a grantback provision may be necessary to ensure that the licensor is not prevented from effectively competing because it is denied access to improvements developed with the aid of its own technology. Compared with an exclusive grantback, a non-exclusive grantback, which leaves the licensee free to license improvements technology to others, is less likely to harm competition.

Why do the antitrust agencies express concern with exclusive grantback licenses? How might the use of grantback licenses impact innovation?

3. *Share-alike and copyleft*. Grantback clauses typically require a licensee to grant a license to its licensor. In some cases, however, a license agreement will require the licensee to grant rights in its derivative works to a broad category of users or to the public at large. These provisions often occur in open source software licenses and Creative Commons online content licenses and are referred to as “share-alike” or “copyleft” licenses, and are discussed in greater detail in [Section 19.2](#).
4. *Consumer grantbacks*. Below is a clause from an end user license agreement for a 3D printer:

Customer hereby grants to Stratasys a fully paid-up, royalty-free, worldwide, non-exclusive, irrevocable, transferable right and license in, under, and to any patents and copyrights enforceable in any country, issued to, obtained by, developed by or acquired by Customer that are directed to 3D printing equipment, the use or functionality of 3D printing equipment, and/or compositions used or created during the functioning of 3D printing equipment ... that is developed using the Products and that incorporates, is derived from and/or improves upon the Intellectual Property and/or trade secrets of Stratasys. Such license shall also extend to Stratasys’ customers, licensors and other authorized users of Stratasys products in connection with their use of Stratasys products.<sup>3</sup>

This license grants the printer manufacturer an irrevocable, royalty-free license to any IP pertaining to 3D printers that is created by a user while using the printer. Is this clause reasonable? How far can such grantback clauses go? Could the manufacturer also seek a royalty-free copyright or design patent license covering anything that the user prints on the printer? Keep these questions in mind when you read [Chapter 24](#) covering IP misuse.

#### Problem 9.1

OverView Systems is the developer of the widely used “FloorMaster” software system for managing factory automation. Malden Robotics has developed a new humanoid robot, the “T-1000,” that accurately mimics human motions. Malden Robotics would like to adapt the T-1000 for use in automotive plants and other factory settings. To do so, Malden Robotics needs to develop a software module that makes the T-1000 compatible with FloorMaster. Assume that you represent OverView, which is willing to grant Malden Robotics a license to “use” FloorMaster internally solely for the purposes of developing the T-1000 compatibility module. Should OverView insist on a grantback clause in this license? If so, draft the terms of the grantback and explain why you have requested them.

### 9.2 LICENSOR DEVELOPMENTS: COMMISSIONED WORKS

In [Section 2.2](#) we discussed the work made for hire doctrine under copyright law, which establishes when the copyright in a commissioned work is owned by the commissioning party, as opposed to the creator. Yet there are many issues beyond the default rules for ownership that arise in the context of commissioned works and technology development.

#### 9.2.1 Allocation of IP for Commissioned Works

When a work – whether it is a public sculpture, a screenplay or a software system – is commissioned, it is usually in the parties’ interest to specify who will own the work that is produced and delivered, rather than relying on the default legal rules of ownership.

<sup>3</sup> [www.stratasys.com/legal/terms-and-conditions-of-sale](http://www.stratasys.com/legal/terms-and-conditions-of-sale). Thanks to Professor Lucas Osborne for bringing this clause to my attention.

In the simplest cases this is merely a question of whether the developer or the customer will own the work, the answer to which is often dictated by industry norms and practices. For example, when a magazine or website commissions a freelance photographer to shoot a celebrity wedding, the copyright in the resulting photos is often retained by the photographer, while the magazine obtains a license to print one or more selected photos. But when a business hires a web designer to create a new corporate website, the copyright in the site is usually transferred to the business upon payment of the design fee. Complications arise, however, in more involved transactions.

#### 9.2.1.1 Customizations

In some cases a customer may engage a developer not to create a new software system from scratch, but to modify an existing platform to work in the customer's environment. For example, a software vendor may have a system that manages logistics for the shipment of products around the world. A distributor in the wine and spirits business may wish to use the platform, but requires modifications to account for specific alcohol excise taxes and transport restrictions that are imposed by different US states and countries. In this case, the vendor is unlikely to assign the customer the copyright in the basic software system. However, the vendor *may* be willing to transfer copyright in the alcohol-specific customizations to the customer. On the other hand, the vendor may predict that the customizations that it develops relating to the wine and spirits trade may translate to other regulated industries, such as pharmaceuticals (not to mention other wine and spirits distributors). The vendor may thus be reluctant to assign copyright in those customizations to its customer. At this point, the parties must work out a mutually satisfactory business solution. Among the almost limitless possibilities are the following:

- The vendor retains copyright in the customizations, but agrees that it will not license them to any other wine or spirits distributor for a period of five years.
- The vendor retains copyright in the customizations, but agrees to pay the customer a royalty of 5 percent if it licenses them to any other wine or spirits distributor and a royalty of 2 percent if it licenses them to a customer in any other industry, which royalty obligation will expire ten years after delivery of the original customizations to the customer.
- The vendor transfers copyright to the customer, but retains a license authorizing it to create derivative works of the customizations for use in industries other than wine and spirits.

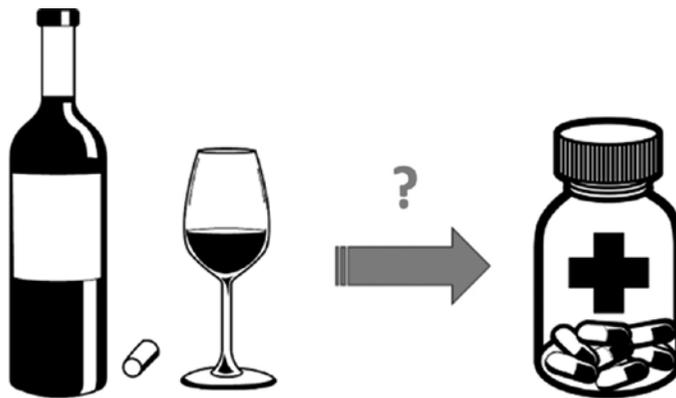


FIGURE 9.1 To what degree might a software logistics system customized for the wine and spirits market be useful in the pharmaceuticals market? The answer will dictate the degree to which the vendor wishes to retain rights to those customizations.

## 9.2.1.2 Third-Party Components

Many complex software systems, electronic devices and pieces of industrial equipment include technology and IP that are not originated by the vendor that makes delivery to a customer. As a result, a variety of third-party IP must be sublicensed by the vendor to its customer. In some cases the vendor's licensing terms may be sufficiently broad to encompass the rights extended by the third parties whose technology is included in its delivery. For example, the license agreement for Apple's Big Sur version of its MacOS operating system contains the following language:

A. The Apple software (including Boot ROM code), *any third party software*, documentation, interfaces, content, fonts and any data accompanying this License whether preinstalled on Apple-branded hardware, on internal storage, on removable media, on disk, in read only memory, on any other media or in any other form (collectively the "Apple Software") are licensed, not sold, to you by Apple Inc. ("Apple") for use only under the terms of this License. Apple *and/or Apple's licensors* retain ownership of the Apple Software itself and reserve all rights not expressly granted to you. You agree that the terms of this License will apply to any Apple-branded application software product that may be preinstalled on your Apple-branded hardware, unless such product is accompanied by a separate license, in which case you agree that the terms of that license will govern your use of that product (emphasis added).

...

P. Third Party Software. Apple has provided as part of the Apple Software package, and may provide as an upgrade, update or supplement to the Apple Software, access to certain third party software or services as a convenience. To the extent that the Apple Software contains or provides access to any third party software or services, Apple has no express or implied obligation to provide any technical or other support for such software or services. Please contact the appropriate software vendor, manufacturer or service provider directly for technical support and customer service related to its software, service and/or products.<sup>4</sup>

In some cases, however, third-party licensors may insist on including their own terms in the license granted by the vendor. For example, the Apple BigSur license also contains the following clause (and several more like it):

This product is licensed under the MPEG-4 Visual Patent Portfolio License for the personal and non-commercial use of a consumer for (i) encoding video in compliance with the MPEG-4 Visual Standard ("MPEG-4 Video") and/or (ii) decoding MPEG-4 video that was encoded by a consumer engaged in a personal and non-commercial activity and/or was obtained from a video provider licensed by MPEG LA to provide MPEG-4 video. No license is granted or shall be implied for any other use. Additional information including that relating to promotional, internal and commercial uses and licensing may be obtained from MPEG LA, LLC. See <https://www.mpegla.com>.

If a customer is concerned about the inclusion of third-party software or components in a deliverable that it is paying a vendor to develop for it, it may request that the vendor list all third-party components in a schedule and seek the customer's approval to include further third-party components in the system.

In addition to potential licensing issues, third-party components can present issues relating to performance, repair, maintenance, security and IP indemnification. As a result, customers are often justifiably wary of the inclusion of large numbers of third-party components in systems that are allegedly being developed to their specifications.

<sup>4</sup> [www.apple.com/legal/sla/docs/macOSBigSur.pdf](https://www.apple.com/legal/sla/docs/macOSBigSur.pdf)

### 9.2.1.3 Customer Materials

In many cases, such as the wine and spirits customization project described above, the vendor/developer will require information, data or even designs from its customer. The treatment of these “customer materials” is often a sensitive topic in licensing negotiations. On one hand, parties generally agree that the customer should retain ownership of such customer materials and that they should be treated as confidential information of the customer. However, disagreement can arise with respect to the ownership or use of customizations based on those customer materials.

### 9.2.2 Technology Development Obligations

Depending on the complexity and cost of a development project, the vendor’s obligations may be spelled out in exceptional detail, including week-by-week tasks, deliverables, charges, required approvals and acceptance criteria.<sup>5</sup> The specifics of a development project are often listed in a “statement of work” or SOW – a document that is often created by technical and business personnel with minimal input from legal. It is a mistake, however, to assume that an SOW does not require careful legal review. Many SOWs, whether intentionally or not, contain significant legal obligations that can lead to disputes and eventual collapse of a relationship (see the case of *iXL*, below).

Depending on the generality of the services described in an SOW, many agreements also provide for individual projects to be authorized pursuant to work orders (also known as work releases and other variants). These documents, like SOWs, form part of the legally binding agreement between the developer and the customer, and are usually signed and appended to the agreement.

In addition to the documents detailing what work the developer must perform, many development agreements contain a document referred to as a specification (“spec”). The specification is generally a technical requirements document jointly developed by the parties which outlines the functionality, performance, reliability and other technical criteria for the system being developed.

In most complex development projects, issues are discovered during the course of development – either additional resources that are required by the developer, or additional requirements that the customer realizes that it has. When this happens, the parties may agree on one or more “change orders” to modify aspects of the then-current SOW or work orders. It is important to remember that change orders must be agreed by both parties – it is the rare agreement that allows one party alone to modify the performance obligations under an agreement.

#### EXAMPLE: CHANGE ORDERS

Neither this Agreement, nor any Work Order, may be modified or amended except via written Change Order signed by an authorized representative of both parties. If Client requests or Developer recommends changes during performance of a Work Order, Developer will provide Client with a written Change Order Proposal setting forth (a) a description of the

<sup>5</sup> A detailed analysis of each of these terms is beyond the scope of this book. For a discussion of technology development contracting practices, see Cynthia Cannady, *Technology Licensing and Development Agreements* (Oxford Univ. Press, 2013).

proposed change(s), (b) impact on price, (c) impact on the production schedule and (d) a revised Statement of Work. Client may, at its discretion, accept or reject any Change Order Proposal. A Change Order Proposal will be considered rejected if Client does not respond to the proposal within ten business days. If accepted, Change Orders will be effective upon execution by both parties. If rejected, Developer will be required to perform in accordance with any then-outstanding Work Orders according to their terms.

Notwithstanding the foregoing, Developer may make minor modifications to software design specifications if such modifications do not limit, diminish or affect the functional operation or use of the software or its output.

The following case illustrates some of the issues that can arise when a development agreement goes sour.

*IXL, Inc. v. AdOutlet.Com, Inc.*

2001 U.S. Dist. LEXIS 3784 (N.D. Ill. 2001)

SCHENKIER, MAGISTRATE JUDGE

**I.**

At its core, this case presents a basic contract dispute between iXL, Inc. (“iXL”) and AdOutlet.Com, Inc. (“AdOutlet”). In its amended complaint, iXL claims that it entered into a contract with AdOutlet to provide consulting and web design services for a fee; that iXL provided the services; that iXL billed AdOutlet \$2,913,708 for the work and expenses associated with those services; but that AdOutlet has paid only \$1,195,505 of the billed amount, leaving a substantial shortfall that iXL now seeks to collect under theories of breach of contract, accounts stated, open book account, and quantum meruit. AdOutlet denies that it owes iXL anything beyond what AdOutlet already has paid; indeed, AdOutlet complains it has paid too much, and has asserted a breach of contract counterclaim seeking recovery of an unspecified amount for “significant costs and expenses” that AdOutlet allegedly has incurred because AdOutlet had to correct short-comings in iXL’s performance.

iXL claims that AdOutlet is using computer source code property that iXL created, but for which AdOutlet has not paid, and that AdOutlet thus has committed misappropriation, conversion and unauthorized use of intellectual property in violation of common law, and copyright infringement ... iXL has moved for a preliminary injunction, seeking to bar AdOutlet from using the computer code and intellectual property allegedly supplied by iXL on AdOutlet’s web site.

On March 22, 2000, iXL and AdOutlet entered into a Master Service Agreement (“the Agreement”), pursuant to which iXL agreed to provide AdOutlet with consulting and web design services on an hourly fee and expense basis. As a substantial part of those services, iXL was to create computer “source code” to assist in the operation of AdOutlet’s web site.

The Agreement contemplated that the specific tasks that iXL would perform, and the price for those tasks, would be set forth in separate Statements of Work (“S.O.W.”), which would incorporate the terms of the Agreement.

Under the Agreement, iXL possessed the authority to “determine the method, details, and means of performing the services to be performed hereunder, subject to the standards set

forth in the Statement of Work and the approval of Client, which shall not be unreasonably withheld.” iXL warranted that it would perform services for AdOutlet “in material conformity to the specifications set forth in a Statement of Work contemplated hereunder in a professional and workmanlike manner.” At the same time, the Agreement contained a disclaimer by iXL, stating that it did not warrant that its services would be “error free,” or that AdOutlet would be able to obtain certain results due to the services provided by iXL, or that iXL was providing any warranty of merchantability, title, or fitness for a particular purpose.

The Agreement specified that for the services provided under the Agreement, AdOutlet “shall pay to iXL the fees in the amount and manner set forth in the Statement of Work,” as well as expenses. The Agreement also set forth the remedies that iXL could pursue in the event of nonpayment by AdOutlet. If AdOutlet failed to pay for sixty days after the date of the invoice, the Agreement authorized iXL’s “suspension of the performance of the services.” The Agreement further provided that if iXL pursued legal action to recover on unpaid invoices, AdOutlet would be liable to pay “in addition to any amount past due, plus interest accrued thereon, all reasonable expenses incurred by iXL in enforcing this Agreement, including, but not limited to, all expenses of any legal proceeding related thereto and all reasonable attorneys’ fees incurred in connection therewith.”

The Agreement provided for various circumstances under which the Agreement could be terminated. For example, the Agreement provided that upon a default of payment by AdOutlet, which had not been cured within thirty days, iXL could terminate the Agreement upon written notice. The Agreement stated that upon termination of the Agreement for any of the specified reasons, AdOutlet “shall be obligated to pay iXL for all services rendered pursuant to any outstanding Statements of Work through the effective date of such termination.”

Pursuant to the Agreement, the parties entered into six separate Statements of Work. The Statements of Work defined the “Services” that iXL would perform as those set forth in the Statement of Work, and “Works” as “all deliverables developed or prepared by iXL in the performance of Services hereunder.” The Statements of Work contemplated that in performing Services and Works for AdOutlet, iXL would use certain “Pre-Existing Works” that already had been developed by iXL; that iXL also would use certain “Client Materials” obtained from AdOutlet, such as information and ideas; and that iXL would create certain new material for AdOutlet. Paragraph 3 of the consulting terms and conditions set forth the ownership rights in these three different categories of materials. Because it is central to the present motion, we set forth below that provision in its entirety:

3. “Work for Hire.” Client shall retain all title to Client Materials, including all copies thereof and all rights to patents, copyrights, trademarks, trade secrets and other intellectual property rights inherent in such Client Materials. iXL shall not, by virtue of this Statement or otherwise, acquire any proprietary rights whatsoever in the Client Materials, which shall be the sole and exclusive property of Client. With the exception of Pre-Existing Works, the Services provided by iXL and the Works shall constitute “work made for hire” for Client ... and Client shall be considered the author and shall be the copyright owner of the Works. If and to the extent that the foregoing provisions do not operate to vest fully and effectively in Client such rights, iXL hereby grants and assigns to Client all rights which may not have so vested, (except for rights in the Pre-Existing Works)

AdOutlet does not dispute that iXL actually worked the hours for which it billed AdOutlet.

During the summer of 2000, iXL sent portions of the source code to AdOutlet by e-mail. On or about October 1, 2000, iXL delivered to AdOutlet two compact discs containing the source code iXL created for the web site. As it was delivered to AdOutlet, the source code provided by iXL bore a legend stating that AdOutlet owns the copyright.

The payment disputes between the parties reflect the ongoing disagreements between the parties during iXL's performance of work ... AdOutlet claims that the source code prepared by iXL was fraught with defects, which over a period of several months iXL had difficulty in correcting and that, as a result, AdOutlet personnel had to fix. AdOutlet claims that the vast majority of the source code used for the AdOutlet web site thus was developed by AdOutlet, and not iXL.

While iXL does not directly dispute that it encountered some difficulties in supplying code and other information that met AdOutlet's requirements, iXL contends that iXL ultimately provided satisfactory code and other information – which iXL contends AdOutlet is using without paying for it.

Despite its criticisms about the quality of the code iXL supplied, AdOutlet admits that it has not exercised its option under paragraph 2.3 of the terms and conditions to the Statements of Work to reject the source code, to return it to iXL, and to terminate the Agreement. Rather, AdOutlet has installed the source code and continues to use it on its web site.

## II.

The difficulty that iXL confronts is in establishing a likelihood of success on the proposition that iXL, rather than AdOutlet, is the owner of a copyright in the source code. On this point, iXL runs headlong into the language of the Agreement that iXL itself drafted. The Statements of Work specifically state that the Works and Services provided by iXL (which include the source code) are works made for hire for AdOutlet, and that AdOutlet “shall be considered the author and shall be the copyright owner of the works.” This language plainly constitutes an express agreement that the source code is work made for hire, as required by 17 U.S.C. § 101. Under 17 U.S.C. § 201(b), the “person for whom the work was prepared [here, AdOutlet] is considered the author for purposes of this title, and, unless the parties have expressly agreed otherwise in a written instrument signed by them, owns all of the rights comprised in the copyright.”

iXL contends that taken together, the Agreement and the Statements of Work show that the parties have “expressly agreed otherwise,” by making full payment of the invoices a condition precedent to AdOutlet's ownership of the source code. In order for iXL to demonstrate likelihood of succeeding on this point, iXL must show both (1) that it is likely to succeed on its claim that AdOutlet breached the contract by nonpayment, and (2) that such a breach deprives iXL of ownership of the source code.

iXL has shown some likelihood of success on this first point. There is nothing here to suggest that the Agreement and the Statements of Work, signed by both parties, are not valid and enforceable. Nor is there any dispute that iXL has billed AdOutlet for some \$2.9 million of time and expense that iXL actually incurred in providing services to AdOutlet, that AdOutlet has not paid nearly that full amount, and that as a result iXL has suffered injury – iXL admittedly has received some \$1.7 million less than it billed AdOutlet. While AdOutlet asserts that iXL failed to perform adequately under the Agreement and that AdOutlet's failure to pay the full amount is thus not a breach, there is evidence that could establish AdOutlet has accepted iXL's work. The evidence shows that AdOutlet has not returned the source code submitted by iXL, and has not exercised

the procedure set forth in the contract for termination upon iXL's failure to timely correct non-conforming works. To the contrary, the evidence shows that AdOutlet is using the source code developed by iXL on the web site, and that the source code developed by iXL is a critical component to the operation of AdOutlet's web site. Given these circumstances, the Court finds that iXL has established some likelihood of success on its claim of breach of contract.

However, iXL has not established a likelihood of success on the proposition that a breach of contract results in AdOutlet being deprived of ownership of the source code. The Statements of Work provide that the Services provided by iXL are "works made for hire" for AdOutlet. The Copyright Act provides that the person for whom the work was prepared is considered the author and owns the rights comprised in the copyright "unless the parties have expressly agreed otherwise in a written instrument signed by them." The Agreement and the Statements of Work contain no express agreement that AdOutlet will be considered the author of the source code and the owner of its copyright only after full payment of the invoices. Nor do these agreements state that AdOutlet is barred from using the source code in its web site if AdOutlet has failed to pay the full invoice amount. Indeed, when iXL delivered the CD ROMs containing the source code on or about October 1, 2000 – by which time AdOutlet already was nearly \$900,000 in arrears in payment for more than 60 days – iXL nonetheless affixed to the code a legend identifying AdOutlet as the holder of the copyright.

In the absence of an express agreement, iXL attempts to cobble together an implied condition that AdOutlet cannot own (or use) the source code until it has made full payment of the invoice price to iXL. iXL points to two provisions in particular, neither of which bears the weight that iXL seeks to place on it.

First, iXL points to paragraph 2.2 of the terms and conditions of the Statements of Work, which state that AdOutlet "shall perform the tasks set forth in the Statement as a condition to iXL's obligations to perform hereunder." iXL claims that this language establishes that full payment by AdOutlet is a condition precedent to AdOutlet being deemed the author and copyright holder of the source code. iXL certainly could have made full payment by AdOutlet a condition precedent. But it is hard to read paragraph 2.2 as doing so. The word "tasks" is not defined in the Agreement or in the Statements of Work. The Court finds it plausible that paragraph 2.2 is to be read in conjunction with paragraph 2.4, which provides that iXL's obligation to meet contractual deadlines is contingent upon AdOutlet complying "in a timely manner, with all reasonable requests of iXL." But to construe "task" to mean "full payment" by AdOutlet, as iXL argues, would make no sense. Read that way, under paragraph 2.2 iXL would have absolutely no "obligations to perform" until AdOutlet first had paid the full contract price – which is clearly not what the parties intended, as measured both by the wording of the contract and the actual course of performance by the parties.

In this case, iXL drafted the Agreement and the Statements of Work, and negotiated it at arms length with AdOutlet. iXL had every opportunity, and presumably every incentive, to provide in the Agreement and the Statements of Work for adequate safeguards to insure payment – including a provision that conditioned AdOutlet's right of ownership in use of the copyrighted information upon payment of the full invoice price. Now that the contract has gone sour, iXL asks the Court to step in and provide it with a remedy (and with leverage) that iXL did not bargain for. The Court does not believe that iXL has shown some likelihood of succeeding in that effort.

## Notes and Questions

1. *Third-party component anxiety.* Why might a customer be concerned about the inclusion of third-party components in a system that is being developed for it? What contractual provisions can the customer include in an agreement to mitigate the risk of these third-party components? To what degree would it be appropriate for the developer of a large enterprise software system to utilize the language about third-party components utilized by Apple in its Big Sur licensing agreement?
2. *Acceptance by use.* In *iXL*, the court makes note of the fact that AdOutlet did not reject the software delivered by iXL, but instead elected to use it to run its website. If AdOutlet were truly dissatisfied with the result of iXL's development project, what would you have advised AdOutlet to do?
3. *Conditions on use.* The court in *iXL* notes that "In the absence of an express agreement, iXL attempts to cobble together an implied condition that AdOutlet cannot own (or use) the source code until it has made full payment of the invoice price to iXL." Not surprisingly (given this lead-in), the court does not recognize the condition that iXL seeks to impose on AdOutlet's use of the software. If you had represented iXL, how would you have drafted the relevant contractual clauses to reflect your client's needs?

## Problem 9.2

We-R-Toyz (WRT) is a national toy retailer that, in addition to selling products offered by Mattel, Hasbro and other leading manufacturers, has its own line of WRT toys. WRT's chief product designer, Max Headroom, has conceptualized a new baby doll that includes sophisticated software that can teach children up to five different languages (English, Spanish, Mandarin, Japanese and Swahili). He calls it "Baby Lingua." WRT's in-house design team has developed the plastic "shell" for the doll, as well as the software and hardware used to move its limbs and head. However, WRT lacks the in-house expertise to develop the language-teaching module.

As a result, Max wishes to contract with Dr. Beatrice Skinner, a world-renowned linguistic software expert and artificial intelligence designer, to develop the language-teaching module for Baby Lingua. Dr. Skinner is interested in the project, and has previously developed software that teaches English and Spanish that could easily be ported into Baby Lingua's computer processor. She will require help, however, to adapt her software to teach Mandarin, Japanese and Swahili. She thinks that she can identify experts in Beijing, Tokyo and Nairobi to perform the necessary work. Given that the holiday season is only eight months away, and sufficient quantities of Baby Lingua will require at least two months to produce, time is of the essence.

As the attorney for WRT, create a prioritized list of the seven most important contractual provisions that will need to be included in any contract with Dr. Skinner for the Baby Lingua project. What concessions do you think Dr. Skinner will request with respect to these provisions, and how would you respond?

## 9.3 JOINT DEVELOPMENTS: FOREGROUND AND BACKGROUND IP

It is often beneficial for independent parties to cooperate on the development of IP. Such cooperative projects exist in all fields of IP development, from film production to pharmaceutical research to software coding to product design. And while industry-specific norms and customs often dictate many of the aspects of these relationships, they share a number of common features and considerations regarding IP ownership and licensing.

### 9.3.1 *Foreground and Background IP*

Joint development projects often involve both pre-existing and newly developed IP. Intellectual property that one party controlled prior to the commencement of the joint development project is often referred to as that party's "background IP." Background IP can also include IP that is developed by a party after the commencement of the joint development project, but outside the context of the project (e.g., within a different company business unit). This newly developed, but unrelated, IP is sometimes referred to as "sideground IP," but is also commonly grouped together with background IP.

Background IP is often licensed by the party that owns it to the other party for use solely in connection with the joint development project. This license is typically nonexclusive and will last only as long as the project continues.

Intellectual property that is developed as part of the joint project is called "foreground IP." Foreground IP can be developed by one party or by both parties together. The legal rules regarding joint ownership of patents, copyrights and trade secrets, as well as works made for hire and employment agreements, will play a role in determining how foreground IP is owned (see [Chapter 2](#)). For the purposes of this analysis, assume that some IP developed during a joint development program will be solely owned by one party or the other, and some will be jointly owned by both parties.

As discussed in [Section 2.5](#), joint ownership of IP is often inconvenient, as it requires coordination of the prosecution, maintenance, licensing and enforcement of such IP. As a result, parties in joint development arrangements often agree to divide ownership of jointly developed IP so that only one party owns any given item of jointly developed IP. This division is usually accomplished by a simple assignment of rights by the party that wishes to transfer its joint ownership interest to the other party. Following this transfer, ownership of the jointly developed IP resides in only one party, which can then grant a license to the other party in appropriate fields (see [Section 9.3.2](#)). In many cases this license will be irrevocable to ensure that a party is not divested of its right to ongoing use of IP that it helped to develop.

### 9.3.2 *Joint and Reserved Fields*

Most joint development agreements include a definition of the "joint field" in which the parties will conduct joint IP development. It is important to define this joint field carefully, as the parties often grant each other rights in their valuable background IP that they use or have licensed in other fields.

In addition to the joint field, each party often stakes out a "reserved field" of use that is core to its own business. A party's reserved field is often designated as a "no-fly zone" for the other party, at least with respect to jointly developed IP. That is, while the parties cooperate on the development of IP for use in the joint field, each may also agree not to tread on the other party's reserved field. For example, licenses of foreground IP often exclude the developing party's reserved field, and when joint IP is assigned to the other party, the developing party may retain a license in its own reserved field.

### 9.3.3 *Payments*

It is not typical for parties to pay royalties with respect to IP licenses granted in connection with joint development projects, with a few exceptions. First, when a party solely develops IP, or jointly developed IP is based on a party's solely owned IP, it may be appropriate for the other

party to pay a royalty for the use of that IP outside of the joint field (i.e., in the nondeveloping party's reserved field).

Table 9.1 illustrates how parties may allocate IP ownership and licenses with respect to IP that they bring to a project and develop during the course of a project. For example, Party A would grant Party B a nonexclusive license to use Party A's background IP, and any foreground IP that is derivative of Party A's owned IP, solely in the joint field. But with respect to Party A's foreground IP that is derivative of Party B's owned IP, Party A would grant Party B an exclusive license (or assignment), retaining only a license to use that IP in the joint field and Party A's field. These allocations are merely examples; actual IP allocations will vary based on the nature of the collaboration and negotiation leverage of the parties.<sup>6</sup>

TABLE 9.1 *Sample allocation of joint development IP rights*

Type of IP	Developer of IP	
	Party A	Party B
Background	Nonexclusive license to B in joint field	Nonexclusive license to A in joint field
Sole foreground (developer derivative)	Nonexclusive license to B in joint field	Nonexclusive license to A in joint field
Sole foreground (new)	Nonexclusive license to B in joint field and B's field (royalty-bearing)	Nonexclusive license to A in joint field and A's field (royalty-bearing)
Sole foreground (partner derivative)	Exclusive license to B for all purposes (or assigned to B), with nonexclusive retained license for joint field and in A's field	Exclusive license to A for all purposes (or assigned to A), with nonexclusive retained license for joint field and in B's field
Joint foreground (developer derivative)	B assigns ownership to A; A grants B nonexclusive license in B's field	A assigns ownership to B; B grants A nonexclusive license in A's field
Joint foreground (partner derivative)	A assigns ownership to B; B grants A nonexclusive license in joint field and A's field	B assigns ownership to A; A grants B nonexclusive license in joint field and B's field
Joint foreground (new)	Jointly owned; A grants B exclusive license in B's field	Jointly owned; B grants A exclusive license in A's field

### Notes and Questions

1. *Joint ownership.* As noted above, and as detailed in Section 2.5, the joint ownership of IP requires coordination of the prosecution, maintenance, licensing and enforcement of such IP, which can be costly and time-consuming. As a result, many attorneys shy away from joint ownership of IP and seek to achieve similar results using a combination of sole ownership and exclusive licenses. But a large number of joint development agreements nevertheless provide for joint ownership of jointly developed IP. Why?

<sup>6</sup> For a more comprehensive treatment of these issues, see Ronald S. Laurie, *Managing Intellectual Property Allocation in Joint Ventures*, in *Licensing Best Practices: Strategic, Territorial, and Technology Issues* (R. Goldscheider & A. H. Gordon, eds., Wiley, 2006).

2. *Reserved fields.* Why do you think that parties tend to seek exclusive rights to jointly developed IP in their reserved fields? What happens if IP has application both in the joint field and a party's reserved field?

### Problem 9.3

American Livery Vehicle (ALV), a large but sagging Detroit manufacturer of light trucks and vans, wants to get into the electric vehicle market. DuraVac is a Japanese consumer battery manufacturer that wishes to enter the market for high-voltage electric vehicle batteries. ALV and DuraVac wish to collaborate to develop a new automotive battery that will meet both of their business needs. Develop a table modeled on Table 9.1 that outlines how the IP brought to the collaboration, and any IP developed during the collaboration, would be allocated between the parties.

## 9.4 IP IN JOINT VENTURES

A joint venture (JV) is a business arrangement in which two or more independent parties contribute resources (e.g., technology, capital, labor, expertise, manufacturing or distribution channels) to pursue a specific business goal. The joint venturers then share risks, rewards and control of the JV. There are many possible forms of JV, but the two most common are (1) a contractual arrangement that assigns each JV party specified rights and responsibilities in pursuing the JV's business goals ("contractual JV"); and (2) the formation of a new entity to pursue the JV's business goals ("entity JV"). A contractual JV is no more than a contractual arrangement specifying a set of rights and obligations of the parties; as such, it is no different than many of the contractual relationships that we have already studied.

In an entity JV, each of the forming parties typically holds an ownership or control interest in the new entity (which is often a limited liability company or limited partnership) and contributes some assets to the JV entity, whether cash, IP, equipment, facilities, services or some combination thereof. The JV operates semi-independently, often hiring its own employees, producing whatever product or service it is formed to pursue, and earning revenue from the sale of that product or service to customers. It may then retain its profits to further invest in the JV business, or distribute some of its earnings to the member parties. An entity JV often has independent management, though the members exercise oversight through their seats on a board of directors or direct voting on the JV's activities. Figure 9.2 illustrates the two principal JV structures.

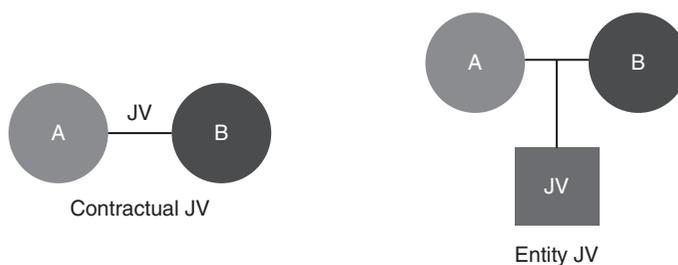


FIGURE 9.2 The two principal JV structures.

## 9.4.1 IP Contributions

The contribution that each JV member makes to an entity determines the size of that member's ownership share in the JV. In the simplest case, each member would contribute an amount of cash to the JV and would receive a proportional share of the JV's ownership interests. However, it is often the case that JV members bring different assets to the JV: some have the necessary financial resources to fund the JV's activities, some have know-how and expert personnel, some have technology and IP rights. All of these contributions may be necessary to ensure the success of the JV, though valuing them appropriately may be difficult.

Contributions of technology and associated IP to a JV can be conceptualized in terms of background IP and foreground IP, as discussed in Section 9.3. The presence of the entity JV itself, however, complicates the picture, as the JV, in addition to each of the members, may either own or license the foreground IP developed by the JV or its members.

Much of the discussion of IP allocation in JVs relates to patents, but significant copyright, trademark and trade secret IP are also contributed to JVs.

## 9.4.2 IP Allocations

Unlike joint development projects and contractual JVs (discussed in Section 9.3), the development of IP within an entity JV focuses most development activity within the entity JV itself. Thus, licenses to the parties' background IP are granted not to the JV member parties, but to the entity JV. Likewise, one of the advantages of creating a JV is to localize development work in the joint field within the JV. Thus, it is likely that the JV members themselves will not be engaged in the development of foreground IP within the JV field. As a result, the various assignments and licenses by the parties contemplated by joint development projects (per Table 9.1) are often absent in an entity JV arrangement.

When the JV itself develops new IP in the joint field, it usually retains such IP with no licenses to its members, on the theory that the entity JV was formed to commercialize IP in the joint field to the exclusion of its members. But when the JV develops IP that is outside the joint field, the members may wish to exploit that IP, at least in their respective reserved fields.

TABLE 9.2 Sample allocation of JV IP rights

Type of IP	Developer of IP		
	Member A	Member B	Joint venture
Background	Exclusive license to JV in joint field	Exclusive license to JV in joint field	N/A
Sole foreground (developer derivative)	N/A	N/A	Exclusive (royalty-bearing) licenses to members in their respective reserved fields
Sole foreground (new)	N/A	N/A	Exclusive (royalty-bearing) licenses to members in their respective reserved fields
Sole foreground (member derivative)	N/A	N/A	Assigned to member that owns underlying IP, with exclusive reserved license in the joint field
Joint foreground	None	None	N/A

As a result, the JV may be required to assign or exclusively license this IP to the members in their reserved fields. Depending on the negotiation leverage of the JV, it may also require that these licenses be royalty-bearing. A slightly different approach may be appropriate when the JV develops IP that is a derivative of background IP licensed to it by a member. In this case, the JV may assign that IP to the member that owns the underlying background IP, while retaining an exclusive license in the joint field.

### 9.4.3 *Exit*

One of the most important things to plan when forming an entity JV is how it will end, and what happens to the JV's assets and liabilities when it ends. Unlike a simple contract, which can generally be terminated by either party for various causes or without cause (see [Chapter](#)

#### *Pav-Saver Corporation v. Vasso Corporation*

493 N.E.2d 423 (Ill. App., 3d Dist., 1986)

#### BARRY, JUSTICE

This matter before us arises out of the dissolution of the parties' partnership, the Pav-Saver Manufacturing Company.

Plaintiff, Pav-Saver Corporation (PSC), is the owner of the Pav-Saver trademark and certain patents for the design and marketing of concrete paving machines. Harry Dale is the inventor of the Pav-Saver "slip-form" paver and the majority shareholder of PSC, located in Moline. H. Moss Meersman is an attorney who is also the owner and sole shareholder of Vasso Corporation. In 1974 Dale, individually, together with PSC and Meersman, formed Pav-Saver Manufacturing Company for the manufacture and sale of Pav-Saver machines. Dale agreed to contribute his services, PSC contributed the patents and trademark necessary to the proposed operation, and Meersman agreed to obtain financing for it. The partnership agreement was drafted by Meersman and approved by attorney Charles Peart, president of PSC. The agreement contained two paragraphs which lie at the heart of the appeal and cross-appeal before us:

3. The duties, obligations and functions of the respective partners shall be:
  - A. Meersman shall provide whatever financing is necessary for the joint venture, as required.
  - B. (1) PAV-SAVER shall grant to the partnership without charge the exclusive right to use on all machines manufactured and sold, its trademark "PAV-SAVER" during the term of this Agreement. In order to preserve and maintain the good will and other values of the trademark PAV-SAVER, it is agreed between the parties that PAV-SAVER Corporation shall have the right to inspect from time to time the quality of machines upon which the licensed trademark PAV-SAVER is used or applied on machines for laying concrete pavement where such machines are manufactured and/or sold. Any significant changes in structure, materials or components shall be disclosed in writing or by drawings to PAV-SAVER Corporation.
  - (2) PAV-SAVER grants to the partnership exclusive license without charge for its patent rights in and to its Patent No. 3,377,933 for the term of this agreement and exclusive

license to use its specifications and drawings for the Slip-form paving machine known as Model MX 6 – 33, plus any specifications and drawings for any extensions, additions and attachments for said machine for said term. It being understood and agreed that same shall remain the property of PAV-SAVER and all copies shall be returned to PAV-SAVER at the expiration of this partnership. Further, PAV-SAVER, so long as this agreement is honored and is in force, grants a license under any patents of PAV-SAVER granted in the United States and/or other countries applicable to the Slip-Form paving machine.

...

11. It is contemplated that this joint venture partnership shall be permanent, and same shall not be terminated or dissolved by either party except upon mutual approval of both parties. If, however, either party shall terminate or dissolve said relationship, the terminating party shall pay to the other party, as liquidated damages, a sum equal to four (4) times the gross royalties received by PAV-SAVER Corporation in the fiscal year ending July 31, 1973, as shown by their corporate financial statement. Said liquidated damages to be paid over a ten (10) year period next immediately following the termination, payable in equal installments.

In 1976, upon mutual consent, the PSC/Dale/Meersman partnership was dissolved and replaced with an identical one between PSC and Vasso, so as to eliminate the individual partners.

It appears that the Pav-Saver Manufacturing Company operated and thrived according to the parties' expectations until around 1981, when the economy slumped, sales of the heavy machines dropped off significantly, and the principals could not agree on the

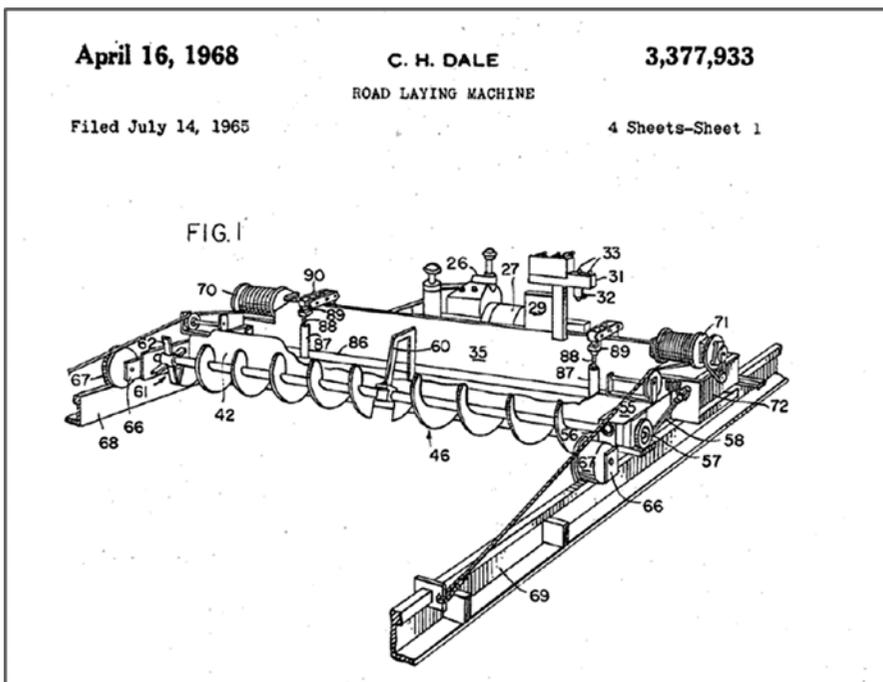


FIGURE 9.3 U.S. Patent No. 3,377,933 was assigned to Pav-Saver Corp. and licensed exclusively to the PSMC joint venture.

direction that the partnership should take to survive. On March 17, 1983, attorney Charles Peart, on behalf of PSC, wrote a letter to Meersman terminating the partnership and invoking the provisions of paragraph 11 of the parties' agreement.

In response, Meersman moved into an office on the business premises of the Pav-Saver Manufacturing Company, physically ousted Dale, and assumed a position as the day-to-day manager of the business. PSC then sued in the circuit court of Rock Island County for a court-ordered dissolution of the partnership, return of its patents and trademark, and an accounting. Vasso counter-claimed for declaratory judgment that PSC had wrongfully terminated the partnership and that Vasso was entitled to continue the partnership business, and other relief pursuant to the Uniform Partnership Act. Other related suits were filed, but need not be described as they are not relevant to the matters before us. After protracted litigation, the trial court ruled that PSC had wrongfully terminated the partnership; that Vasso was entitled to continue the partnership business and to possess the partnership assets, including PSC's trademark and patents; that PSC's interest in the partnership was \$165,000, based on a \$330,000 valuation for the business; and that Vasso was entitled to liquidated damages in the amount of \$384,612, payable pursuant to paragraph 11 of the partnership agreement. Judgment was entered accordingly.

Both parties appealed. PSC takes issue with the trial court's failure to order the return of its patents and trademark or, in the alternative, to assign a value to them in determining the value of the partnership assets. Further, neither party agrees with the trial court's enforcement of their agreement for liquidated damages. In its cross-appeal, PSC argues that the amount determined by the formula in paragraph 11 is a penalty. Vasso, on the other hand, contends in its appeal that the amount is unobjectionable, but the installment method of payout should not be enforced.

In addition to the aforesaid paragraphs of the parties' partnership agreement, the resolution of this case is controlled by the dissolution provision of the Uniform Partnership Act (Ill. Rev. Stat. 1983, ch. 106 1/2, pars. 29 through 43). The Act provides:

- (2) When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:
  - (a) Each partner who has not caused dissolution wrongfully shall have,
    - ...
    - II. The right, as against each partner who has caused the dissolution wrongfully, to damages for breach of the agreement.
  - (b) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name, either by themselves or jointly with others, may do so, during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable under clause (2a II) of this section, and in like manner indemnify him against all present or future partnership liabilities.
  - (c) A partner who has caused the dissolution wrongfully shall have:
    - ...
    - II. If the business is continued under paragraph (2b) of this section the right as against his co-partners and all claiming through them in respect of their interests in the

partnership, to have the value of his interest in the partnership, less any damages caused to his co-partners by the dissolution, ascertained and paid to him in cash, or the payment secured by bond approved by the court and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest the value of the good will of the business shall not be considered.

Initially we must reject PSC's argument that the trial court erred in refusing to return Pav-Saver's patents and trademark pursuant to paragraph 3 of the partnership agreement, or in the alternative that the court erred in refusing to assign a value to PSC's property in valuing the partnership assets. The partnership agreement on its face contemplated a "permanent" partnership, terminable only upon mutual approval of the parties (paragraph 11). It is undisputed that PSC's unilateral termination was in contravention of the agreement. The wrongful termination necessarily invokes the provisions of the Uniform Partnership Act so far as they concern the rights of the partners. Upon PSC's notice terminating the partnership, Vasso elected to continue the business pursuant to section 38(2)(b) of the Uniform Partnership Act. As correctly noted by Vasso, the statute was enacted "to cover comprehensively the problem of dissolution ... [and] to stabilize business." Ergo, despite the parties contractual direction that PSC's patents would be returned to it upon the mutually approved expiration of the partnership (paragraph 3), the right to possess the partnership property and continue in business upon a wrongful termination must be derived from and is controlled by the statute. Evidence at trial clearly established that the Pav-Saver machines being manufactured by the partnership could not be produced or marketed without PSC's patents and trademark. Thus, to continue in business pursuant to the statutorily granted right of the party not causing the wrongful dissolution, it is essential that paragraph 3 of the parties' agreement – the return to PSC of its patents – not be honored.

Similarly, we find no merit in PSC's argument that the trial court erred in not assigning a value to the patents and trademark. The only evidence adduced at trial to show value of this property was testimony relating to good will. It was unrefuted that the name Pav-Saver enjoys a good reputation for a good product and reliable service. However, inasmuch as the Uniform Partnership Act specifically states that "the value of the good will of the business shall not be considered", we find that the trial court properly rejected PSC's good-will evidence of the value of its patents and trademark in valuing its interest in the partnership business.

Next, we find no support for PSC's argument that the amount of liquidated damages awarded to Vasso pursuant to the formula contained in paragraph 11 of the parties' agreement is a "penalty." [T]he test for determining whether a liquidated damages clause is valid as such or void as a penalty is stated in section 356 of the *Restatement (Second) of Contracts*:

Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.

The burden of proving that a liquidated damages clause is void as a penalty rests with the party resisting its enforcement.

PSC has not and does not argue that the amount of liquidated damages was unreasonable. (Significantly, neither party purported to establish that actual damages suffered by Vasso were either more or less than \$384,612.) PSC now urges, however, that "[t]he

ascertainment of the value of the Pav Saver partnership for purposes of an accounting are [sic] easily ascertained. The accountants maintain detailed records of accounts payable and receivable and all equipment.” In advancing this argument, PSC misconstrues the two-part test of a penalty: (1) whether the amount fixed is reasonable in light of the anticipated or actual loss caused by the breach; and (2) the difficulty of proving a loss has occurred, or establishing its amount with reasonable certainty. The difficulty or ease of proof of loss is a matter to be determined at the time of contracting – not, as PSC suggests, at the time of the breach.

It appears clear from the record that Meersman, with some insecurity about his partner’s long-term loyalty to the newly formed partnership, insisted on a liquidated damages provision to protect his financial interests. Nonetheless the record discloses that the agreement was reviewed by Peart and not signed until it was acceptable to both parties. As of December 31, 1982, the date of its last financial statement prior to trial, Pav-Saver Manufacturing Company carried liability on notes owed to various banks amounting to \$269,060. As of December 31, 1981, the loans outstanding amounted to \$347,487. These loans, the record shows, were obtained primarily on the basis of Meersman’s financial ability to repay and over his signature individually. The amount of liquidated damages computed according to the formula in the parties agreement – \$384,612 – does not appear to be greatly disproportionate to the amount of Meersman’s personal financial liability. As earlier stated, the slip-form Pav-Saver machines could not be manufactured and marketed as such without the patents and trademark contributed by Pav-Saver Corporation. Likewise, the services of Dale were of considerable value to the business.

In sum, we find there is no evidence tending to prove that the amount of liquidated damages as determined by the formula was unreasonable. Nor can we say based on the evidence of record that actual damages (as distinguished from a mere accounting) were readily susceptible to proof at the time the parties entered into their agreement. Suffice it to say, the liquidated damages clause in the parties’ agreement appears to have been a legitimate matter bargained for between parties on equal footing and enforceable upon a unilateral termination of the partnership. We will not disturb the trial court’s award of damages to Vasso pursuant to the liquidated damages formula.

We turn next to Vasso’s arguments urging reversal of the trial court’s decision to enforce paragraph 11 of the parties’ agreement with respect to the manner of paying out the amount of damages determined by the formula. The paragraph provides for the liquidated sum to be paid out in equal installments over a 10-year period. The trial court held that the \$384,612 owed by PSC should be paid in 120 monthly installments of \$3205.10 each commencing with March 17, 1983. In support of its argument that it was entitled to a setoff of the full amount of liquidated damages, including the unaccrued balance, Vasso argues that the doctrine of equitable setoff should apply on these facts and further urges that such setoff is required by statute.

In considering whether the liquidated damages formula contained in paragraph 11 of the partnership agreement was enforceable, we necessarily scrutinized the totality of the agreement – not merely the dollar figure so determined. Certainly at first blush the formula appears to yield a suspiciously high amount that is not directly related to any anticipated damages that either party might incur upon a wrongful termination of the agreement by the other. The manner of payout however – equal installments over a 10-year period – appears to temper the effect that the amount of liquidated damages so determined would have on the party who breached the agreement. In our opinion, the validity of the clause

is greatly influenced by the payout provision. What might have been a penalty appears to be a fairly bargained-for, judicially enforceable, liquidated damages provision. While, in hindsight, Vasso may sense the same insecurity in enforcement of the paragraph in toto that Meersman had hoped to avoid by insisting on the provision in 1974 and 1976, Vasso's concerns of PSC's potential insolvency are neither concrete nor sufficiently persuasive to entitle it to a right of setoff.

The primary authority cited in support of Vasso's equitable setoff argument is inapposite. There, the debtor was insolvent. In this case, PSC has been shown to have relatively little in operating finances, but has not been proved incapable of paying its creditors. Were PSC obliged to pay out the full amount of liquidated damages at this point, PSC's insolvency would be a certainty. However, PSC's assets and financial condition were known to Vasso at the time the parties agreed to become partners. Vasso cannot contend that its partner's potential insolvency in the event of a wrongful termination by it was unforeseeable at the time of contracting. We do not find that the equities so clearly favor Vasso as to require application of the doctrine of equitable setoff in disregard of the parties' agreement for installment payments.

Further, our reading of section 38(2) of the Uniform Partnership Act fails to persuade us that the statute requires a setoff of the liquidated damages. That section permits the partner causing the dissolution (PSC) to have the value of its interest in the partnership, less "any damages recoverable [by Vasso]" (subparagraph (b)) or "any damages caused [by PSC]" (subparagraph (c)), paid in cash. It does not require a cash setoff, however, in the unusual event (this case) wherein damages exceed the value of the terminating partner's interest.

Where, as here, a valid liquidated damages clause is enforceable, that clause may be implied into the statute to the extent that it does not violate the legislative intent of the Act. We do not believe that the legislative purpose of stabilizing business is frustrated by limiting Vasso's statutory setoff to past accrued damages and enforcing the payout terms of the parties' agreement. Under the circumstances, we perceive of no compelling grounds, legal or equitable, for ignoring or rewriting paragraph 11 of the parties' agreement. Therefore, all statutory references to "damages" recoverable by Vasso are supplanted by the parties' agreement for liquidated damages. As the trial court properly ruled, enforcement of the agreement results in a judgment for PSC in the amount of its share of the value of the partnership assets (\$165,000) set off by past due installments of liquidated damages accrued from the date of the partnership's termination (March 17, 1983), and an ongoing obligation to pay out the balance monthly during the 10-year period which would end in March of 1993.

For the foregoing reasons, we affirm the judgment of the circuit court of Rock Island County.

Affirmed.

JUSTICE STODER, concurring in part and dissenting in part:

I generally agree with the result of the majority. I cannot, however, accept the majority's conclusion the defendant is entitled to retention of the patents.

The Uniform Partnership Act (UPA) is the result of an attempt to codify and make uniform the common law. Partners must act pursuant to the provisions of the Act which apply when partners have not agreed how they will organize and govern their ventures. These UPA provisions are best viewed as "default" standards because they apply in the absence of contrary agreements. The scope of the Act is to be determined by its provisions and is

not to be construed to extend beyond its own proper boundaries. When the partnership contract contains provisions, imposing on one or more of the partners obligations differing from those which the law ordinarily infers from the partnership relation, the courts should strive to construe these provisions so as to give effect to the honest intentions of the partners as shown by the language of the contract and their conduct under it.

The plaintiff (PSC) brought this action at law seeking dissolution of the partnership before expiration of the agreed term of its existence. Under the Uniform Partnership Act where dissolution is caused by an act in violation of the partnership agreement, the other partners are accorded certain rights. The partnership agreement is a contract, and even though a partner may have the power to dissolve, he does not necessarily have the right to do so. Therefore, if the dissolution he causes is a violation of the agreement, he is liable for any damages sustained by the innocent partners as a result thereof. The innocent partners also have the option to continue the business in the firm name provided they pay the partner causing the dissolution the value of his interest in the partnership.

The duties and obligations of partners arising from a partnership relation are regulated by the express contract as far as they are covered thereby. A written agreement is not necessary but where it does exist it constitutes the measure of the partners' rights and obligations. While the rights and duties of the partners in relation to the partnership are governed by the Uniform Partnership Act, the Uniform Act also provides that such rules are subject to any agreement between the parties. It is where the express contract does not cover the situation or question which arises that they are determined under the applicable law, the Uniform Partnership Act.

The partnership agreement entered into by PSC and Vasso, in pertinent part, provides: 3.B.(2) [PSC] grants to the partnership exclusive license without charge for its patent rights ... for the term of this agreement ... [I]t being understood and agreed that same shall remain the property of [PSC] ... and shall be returned to [PSC] at the expiration of this partnership ... The majority holds this provision in the contract is unenforceable. The only apparent reason for such holding is that its enforcement would affect defendant's option to continue the business. No authority is cited to support such a rule.

The partnership agreement further provides:

11. ... If either party shall terminate or dissolve said [partnership], the terminating party shall pay to the other party as liquidated damages [\$ 384,612].

This provision becomes operative at the same time as the provision relating to the return of the patents.

Partnership agreements are governed by the same general rules of construction as are other written agreements. If their provisions are explicit and unambiguous and do not violate the duty of good faith which each partner owed his copartners, the courts should carry out the intention of the parties. The Uniform Partnership Act should not be construed to invalidate an otherwise enforceable partnership agreement entered into for a legitimate purpose.

Here, express terms of the partnership agreement deal with the status of the patents and measure of damages, the question is settled thereby. I think it clear the parties agreed the partnership only be allowed the use of the patents during the term of the agreement. The agreement having been terminated, the right to use the patents is terminated. The provisions in the contract do not conflict with the statutory option to continue the business and even if there were a conflict the provisions of the contract should prevail. The option

to continue the business does not carry with it any guarantee or assurance of success and it may often well be that liquidation rather than continuation would be the better option for a partner not at fault.

As additional support for my conclusion, it appears the liquidated damages clause was insisted upon by the defendant because of earlier conduct of the plaintiff withdrawing from a former partnership. Thus, the existence of the liquidated damages clause recognizes the right of plaintiff to withdraw the use of his patents in accordance with the specific terms of the partnership agreement. Since liquidated damages depends on return of the patents, I would vacate that part of the judgment providing defendant is entitled to continue use of the patents and provide that use shall remain with plaintiff.



FIGURE 9.4 A Pav-Saver road-paving machine.

12), an entity JV has separate legal existence, and its termination and dissolution are often more complex. Events triggering a termination of a JV include mutual agreement of the JV members, the withdrawal of a JV member or the sale of the JV, either to a third party or to one of the members. Upon the dissolution of an entity JV, the ownership of the JV's assets, including IP, must be disentangled, with attention to the rights that each member will acquire and responsibility for the JV's liabilities.

The following case illustrates the issues that can arise when the agreements constituting a JV inadequately address issues of IP ownership and the effects of the JV's termination.

#### Notes and Questions

1. *JV allocations.* Table 9.2, illustrating a typical allocation of IP in an entity JV, differs substantially from Table 9.1, illustrating IP allocations in a typical two-party joint development arrangement or contractual JV. How do you explain the significant differences between these two frameworks for allocating IP?

2. *JV-developed IP*. If a JV develops IP outside of the joint field, it will often license that IP to its members in their respective reserved fields on an exclusive basis. Sometimes, the JV will charge the members royalties for these licenses. What justifies the granting of these exclusive licenses and the charging of royalties for them? Why is the situation different when the JV develops IP that is a derivative of the background IP licensed to it by a member?
3. *The Pav-Saver contributions*. In 1974, the Pav-Saver Manufacturing Co. (PSMC) was a classic three-party JV in which Dale contributed services, Meersman contributed capital and PSC contributed IP. Why do you think the JV was formed? Do these initial contributions seem reasonable to accomplish the JV's goals? Why do you think the JV was restructured in 1976 to combine the interests of Dale and PSC?
4. *A conflict of terms*. The PSMC JV agreement clearly contained drafting flaws, including the facially contradictory statements that the JV was intended to be "permanent" and could not be dissolved or terminated without the approval of both parties, and the statement that if either party terminated or dissolved the JV it would pay liquidated damages to the other. Is there any way to reconcile these statements? What do you think the parties intended when they drafted this language?
5. *The Pav-Saver result*. Following the dissolution of the PSMC JV, Vasso, as the party continuing to run the PSMC business, was entitled to retain the exclusive patent and trademark license originally contributed by PSC in exchange for a payment to PSC of \$165,000 (the value of 50 percent of the business). PSC, on the other hand, was required to pay Vasso liquidated damages of \$384,000 with no entitlement to the patent or trademark license. PSC thus emerged from the JV with a net cash loss of \$219,000 as well as the inability to use its own patent and trademark in the business that it created. Is this result sensible? How could PSC have avoided this seemingly inequitable result?
6. *Another way?* In his dissent, Justice Souder argued that Vasso should not get the benefit of the exclusive patent license. Why not? How would Vasso operate the PSMC business without the benefit of the patent license?
7. *Trademarks and JVs*. Much of the discussion surrounding JV IP often centers on patents, but trademarks can be as, or more, important than patent rights in many JVs. In *Pav-Saver*, PSC granted the PSMC JV an exclusive license not only to its patents, but to the PAV-SAVER mark. Why did it do this?

Unlike PSC, in many cases the members of a JV are not willing to allow the JV to use their proprietary marks to market or produce a new product. Why not? If this is the case, a new name is often devised for the JV and its product lines. The trademark rights in these names are often held by the JV itself. But what happens to those rights when the JV dissolves? As demonstrated by *Pav-Saver*, the parties should be careful to specify the fate of all JV-related IP upon a termination or dissolution of the JV.

#### Problem 9.4

Refer to the case *Pav-Saver v. Vasso*. You have been assigned to represent Pav-Saver Corp. (PSC) at the outset of the transactions described in the case. Draft a set of IP ownership/licensing (foreground and background) and termination provisions for the JV agreement that avoids the problems that arose in the case.

<sup>7</sup> See Section 8.7.

## 9.5 IP MAINTENANCE AND PROSECUTION

Patents and trademarks must be “prosecuted” through an examination process at the Patent and Trademark Office before they are issued as registered IP rights. After issuance, registrants must pay periodic maintenance fees and file required documentation in order to maintain these rights.<sup>7</sup> But, as discussed in [Section 7.2.3](#), patent and trademark owners have significant latitude to protect, maintain and renew their registrations at their own discretion, and absent contractual requirements to the contrary courts have been reluctant to recognize any duty that they do so. Likewise, joint owners of IP generally have no duty to one another to maintain their jointly owned IP.

As a result, there are many circumstances under which it is necessary for the parties to an IP licensing agreement to specify which party will bear the responsibility for prosecuting and

## EXAMPLE 1: PATENT PROSECUTION (LICENSOR’S SOLE CONTROL)

Licensor shall have the sole right, in its reasonable discretion, to prosecute and maintain the patent applications and patents included in the Licensed Patents [, including defense of the patents against invalidity and opposition proceedings [1]], subject to Licensee’s obligation to reimburse Licensor set forth in Section \_\_\_ above [2].

## EXAMPLE 2: PATENT PROSECUTION (LICENSOR’S FIRST RIGHT WITH LICENSEE STEP-IN)

Licensor shall have the sole right to prosecute and maintain the patent applications and patents included in the Licensed Patents, provided that for so long as Licensee retains exclusive rights under this Agreement, Licensor shall:

- (a) notify Licensee of the status of the prosecution of all of the applications included in the Licensed Patents;
- (b) consult with, and reasonably consider all suggestions made by Licensee in prosecuting the applications, and maintaining all issued patents, included in the Licensed Patents, including the countries in which to file and maintain applications and issued patents [3];
- (c) notify Licensee of any intent, with respect to any country [3], to abandon or allow the lapse of any patent application or patent included within the Licensed Patents or not to oppose any action or opposition seeking to invalidate any patent [1]. Upon receipt of such notice, Licensee shall have the right, in its own name, to assume maintenance and prosecution of such patent application or patent in such country; and, in such event, Licensor shall execute such documents and provide such other documentation, data or assistance as shall be reasonably requested by Licensee to maintain or prosecute such rights, provided that upon the termination of the license(s) with respect to such Licensed IP, Licensee shall, at Licensor’s request and expense, promptly assign to Licensor all of its rights in such foreign registrations and file all documentation necessary to transfer authority for such prosecution to Licensor or its designated agent [4].

<sup>8</sup> Reimbursement for the costs of prosecution and maintenance is covered in [Section 8.7](#). Responsibility for asserting licensed rights against infringers is covered in [Section 11.2](#).

## EXAMPLE 3: PATENT PROSECUTION (LICENSEE'S RIGHT)

Following the Effective Date, Licensee shall assume control, in its own name, over the prosecution and maintenance of the patent applications and patents included in the Licensed Patents at its sole expense, using counsel of its selection which are reasonably acceptable to Licensor. Licensee shall promptly provide to Licensor copies of all correspondence, applications, amendments, office actions, decisions and other materials relating to the prosecution and maintenance of the Licensed Patents. Licensor shall make its technical personnel reasonably available to Licensee, at Licensee's expense, to provide any technical or scientific information required in connection with the prosecution and maintenance of the Licensed Patents.

Upon the termination of the license(s) with respect to such Licensed IP, Licensee shall, at Licensor's request and expense, promptly assign to Licensor all of its rights in such foreign registrations and file all documentation necessary to transfer authority for such prosecution to Licensor or its designated agent [4].

## DRAFTING NOTES

- [1] *Invalidity proceedings* – in the United States, Europe and other countries, proceedings of various types (*inter partes review*, oppositions, etc.) can be initiated at patent offices to invalidate issued patents and trademarks. Because these proceedings are semi-administrative in nature, and are not part of court-based litigation, they are sometimes treated as part of the prosecution process.
- [2] *Cost reimbursement* – as noted above, some licensors, particularly academic institutions, require that their exclusive licensees reimburse them for the costs of patent prosecution and maintenance. See [Section 8.7](#) for a discussion of these provisions.
- [3] *Countries* – some licensors will be accustomed to filing for protection only in the United States or a handful of major jurisdictions. A licensee that has global aspirations, however, may wish to secure protection in additional jurisdictions. Foreign filings can quickly become costly, however, so some licensors may not be willing to file in all countries desired by their licensees. Provisions such as these enable a licensee to assume control over foreign filings that the licensor is not willing to pursue.
- [4] *Transfer back* – if the licensee is given the authority to prosecute patents in its own name in foreign jurisdictions, such rights must be transferred back to the licensor upon termination of the license. Otherwise, the licensor may be unable to grant worldwide rights to future licensees or exploit the rights in those jurisdictions itself. However, if the licensed IP is close to expiration, or of little value in a particular country, the licensor may not wish to assume such expenses. For this reason, a transfer back of prosecution authority should occur only if requested by the licensor.

maintaining licensed IP rights, and how the parties will interact with respect to such matters.<sup>8</sup> Rights prosecution and maintenance are usually not a concern for nonexclusive licensees, but can be of significant importance to exclusive licensees as well as parties to joint development agreements and joint venture members.

9.5.1 *Responsibility for Prosecution and Maintenance*

Below are three different examples of clauses allocating responsibility for patent prosecution

## EXAMPLE: IP MANAGEMENT COMMITTEE

Promptly following the Effective Date, the Parties shall form an IP Management Committee consisting of each Party's Project Manager, a representative of each Party's intellectual property office, and one other representative appointed by each Party. The Project Managers shall act as co-chairs of the Committee.

The Committee shall meet at least quarterly in person or via video conference. At least two representatives of each Party must be present in order for the Committee to conduct business. Decisions will be taken on the basis of majority vote.

The Committee shall have responsibility for the following functions connected with the IP generated by the Project:

- a. evaluation of invention disclosures and decisions regarding which to advance to patent application drafting,
- b. decisions regarding patent prosecution strategy, including jurisdictions in which to pursue protection,
- c. selection of counsel and patent agents in various jurisdictions where protection is sought,
- d. decisions regarding defense of oppositions and other challenges to patents,
- e. decisions regarding licensing of project IP to third parties,
- f. assessment of infringement threats and making recommendations to the Parties' management regarding enforcement of project IP against alleged infringers, it being understood that no litigation shall be commenced without the mutual written agreement of each Party [1],
- g. development of an annual IP budget to be presented for review and approval by the Finance Department of each Party [2].

## DRAFTING NOTES

[1] *Authority to litigate* – in general, an organization's upper management will need to be involved in any decision to initiate litigation. Thus, while an IP management committee can make recommendations, the final decision will usually rest with a party's management.

[2] *Budget* – this provision assumes that the parties will generally split the cost of IP management and prosecution. If one party will bear these costs alone, then a committee may have less authority over budgetary (and most other) matters.

and maintenance. As you review these, consider how they differ and under what circumstances each would be most appropriate.

### 9.5.2 IP Management

In some cases, such as joint development programs, joint ventures and large technology collaborations, the parties wish to make decisions regarding IP management collaboratively, rather than ceding this right to a single party, whether the licensor or the licensee. To do this, the agreement often calls for the formation of an IP management committee with a range of duties and responsibilities relating to IP management, prosecution and oversight. There are countless ways to organize such a committee, with one example set forth below.

### Notes and Questions

1. *Nonexclusive licensees*. Why do you think that nonexclusive licensees are rarely given any authority over IP prosecution and maintenance? Are there arguments that a nonexclusive