

Term, Termination and Breach

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12.1 TERM OF AGREEMENT

Every agreement has a term – the period of time during which the agreement is in effect. This section discusses some of the basic features that define an agreement’s term, following which [Section 12.2](#) addresses issues relating to the duration of IP licenses that are granted under an agreement. The remainder of this chapter then discusses the ways that agreements and licenses can be terminated, and what effect that termination has.

EXAMPLE: TERM

Unless earlier terminated as provided in Section __ below, the Term of this Agreement shall run from the Effective Date until the third (3rd) anniversary thereof [, provided, however, that the Term shall automatically renew for additional one-year periods unless either party gives the other party written notice that it does not wish the Agreement to so renew at least sixty (60) days prior to the scheduled end of the then-current Term].

12.1.1 *Beginning of the Term*

The term of an agreement often begins when the agreement is signed by all parties or “fully executed.” If an agreement does not specify another date, this is when the agreement would generally be considered effective. However, many agreements do specify a particular date after signing for effectiveness (the “Effective Date”). Sometimes a condition precedent other than execution must be met before an agreement becomes effective, such as obtaining a governmental permit or approval.

In some cases, parties wish to make their agreements effective retroactively (i.e., the agreement is effective as of January 1, even though it is not fully executed until February 20). Sometimes

retroactivity of this nature is not problematic, particularly if it is just a matter of days. But if parties attempt to make an agreement retroactive over a longer period of time, unintended consequences can arise. For example, obligations triggered by the effective date of the agreement, such as up-front payments, may be overdue as soon as the agreement is signed. Likewise, obligations relating to confidentiality, noncompetition and the like could be deemed to be violated if an agreement is suddenly effective retroactively to a time before the parties were aware of the obligations that would be imposed on them. Parties should be especially wary of retroactivity that can affect tax or financial reporting obligations – it can be illegal to “shift” revenue from one quarter to another through retroactive contract dating.

12.1.2 *End of the Term: Expiration*

Most agreements have a natural ending point. The end of the term of an agreement can be specified in terms of a certain date (“the Term of this Agreement shall continue until December 31, 2025”) or a defined period of time (“the Term of this Agreement shall continue until the fifth (5th) anniversary of the Effective Date”).

An agreement term can also end upon the occurrence of some defined event – the sale of a company, the completion of a project or the resignation or death of an individual, for example. There are few legal constraints on the types of events that can trigger the end of an agreement term (though see [Section 21.5](#) regarding the illegality of “*ipso facto*” bankruptcy termination clauses).

When the term of an agreement expires, the rights and obligations of the parties, including all licenses granted, typically end, subject to certain terms that may survive (see [Section 12.5](#)).

12.1.3 *Renewals and Extensions*

The term of an agreement can always be extended by mutual consent of the parties, and many agreements are extended via a series of written extensions and amendments. These are generally enforceable without additional consideration, so long as both parties agree and validly document their agreement.

Nevertheless, some parties wish to avoid the repeated need for contract extensions and instead provide for automatic renewal of their agreements at the end of their term. The above example illustrates a common formulation: The agreement will automatically renew for renewal terms of one year each unless one of the parties notifies the other, with sufficient lead time, that it does not wish the agreement to renew. Automatic renewals are useful because they eliminate the risk that the parties, years into a fruitful relationship, will forget that their agreement is about to expire. There are many examples of parties continuing to cooperate, sell products and pay royalties years after their original agreement has expired. This informal type of extension is often fine, until a dispute arises over the agreement. Then the parties must contend with the formal lack of any agreement at all or try to persuade a court of the terms on which they tacitly “renewed” their relationship.

Sometimes there is an absolute limit on automatic agreement renewals (e.g., “further provided that there shall be no more than seven (7) automatic renewals under this Agreement”). However, such limitations are uncommon in IP licensing agreements.

A key term in automatic renewals is how much notice one party must give the other of its intention not to renew the agreement. Especially if performance under an agreement requires a party to retain staff, make capital investments and conduct business with third parties, it

would be unreasonable to pull the rug out from under that party with no notice at the end of the then-current term. Thus, nonrenewal notice periods are often lengthy (six months would not be unusual), depending on the level of inconvenience that the other party will suffer when the agreement ends. But no matter how generous the nonrenewal notice period may be, once it is embodied in the agreement, a party must comply with it in order to prevent the automatic renewal of the agreement from occurring. See, e.g., *Otis Elevator Co. v. George Washington Hotel Corp.*, 27 F.3d 903, 909 (3d Cir. 1994) (under Pennsylvania law, failure to comply with a ninety-day deadline for providing notice of nonrenewal prior to automatic renewal of an agreement renders termination ineffective even without a showing of prejudice by the nonterminating party).

Another issue that arises in the context of agreement renewals is the degree to which a licensor can increase its fees when the agreement is renewed. Some agreements include a cap on such increases, though it is unclear how enforceable such caps are, as the licensor may simply elect not to renew the agreement under those terms, leaving the licensee with no choice but to renegotiate at a higher rate. See *SEI Global Svcs. v. SS&C Advent*, No. 20-1148 (E.D. Pa., Oct. 23, 2020) (a software license agreement with annual renewals imposed a cap of 3 percent on fee increases, but the licensor allegedly refused to renew unless the licensee accepted a 40 percent fee increase).

Notes and Questions

1. *Numerus clausus need not apply.* As students of real property law will recall, the ancient *numerus clausus* principle provides for legal recognition of a finite set of defined forms of the estates in land: fee simple absolute, fee simple determinable, life estate, etc. The leasehold is another form of estate – one that has a defined term. With respect to leaseholds, it is not permissible to define the term except through one of the recognized forms. Thus, a leasehold may have a term of years (a fixed number of hours, days, weeks, months, years or other measurable period), or may be periodic – existing period to period until terminated. But a lease may not be for a duration that is measured by external events, such as “for the duration of the war” or “until my spouse remarries.” The *numerus clausus* principle does not, however, apply to licensing agreements, which may be structured in any manner desired by the parties (within the bounds of antitrust and other legal rules). Thus, a license agreement could be terminated upon a cessation of military hostilities, a marriage or any other event that the parties desire. Is this degree of flexibility a good thing, or should licensing agreements be treated more akin to leaseholds, with fixed and invariable forms?
2. *Extension versus longer term.* If you were negotiating an agreement, would you prefer a longer term (say, ten years) or a shorter term with automatic renewals (say, five years with up to five one-year renewals)? What advantages and disadvantages are inherent in each approach?

12.2 DURATION OF LICENSES

Recall our discussion in [Chapter 2](#) of the difference between a licensing *agreement* and an IP license. A license is a set of rights that is conveyed by one party to another, usually through the vehicle of a licensing agreement. Yet licensing agreements often contain many additional rights and obligations beyond the bare license grant. These include payment and milestone obligations, services, confidentiality, indemnification, warranties and a host of others. Accordingly, it

is useful to think about the duration of particular licenses that are granted under a licensing agreement separately from the term of the licensing agreement itself.

12.2.1 *Duration Coincident with Agreement Term*

In many cases, the duration of a license will be identical to the term of the agreement under which it is granted. This duration is often explicit in the grant clause of the agreement (“Licensor hereby grants Licensee a nonexclusive license . . . during the Term of this Agreement”). However, if the grant clause is silent as to the duration of a license, it will typically be interpreted to run concurrently with the term of the agreement.

12.2.2 *Duration When an Agreement States No Term*

In some cases, an agreement will state no defined term, nor will the license grant clause include any temporal limitation. In these cases (which should be avoided by careful contract drafters), courts have held that the duration of the license in question is the remaining term of protection of the licensed IP rights.¹ Thus, if a license is granted in 2020 under a patent that expires in 2031, the license will last so long as the patent remains valid and enforceable – which may occur at the expiration of the patent, an earlier date if required maintenance fees are not paid or a different earlier date if the patent is invalidated or rendered unenforceable in a legal action.

12.2.3 *“Perpetual” and IP-Duration Licenses*

A number of license grant clauses provide that the license will be “perpetual.” As the court in *Warner-Lambert* (reproduced below) aptly points out, “The word ‘perpetuity’ is often applied very loosely to contractual obligations. Indiscriminate application of the term serves only to confuse.”

Technically, a perpetual license is one that remains in effect for so long as the licensed IP right remains in force, because an IP holder is generally not permitted to control or charge for the use of an IP right after its expiration (see [Chapter 24](#) discussing IP misuse). Thus, a “perpetual” license of patents or copyrights will last only so long as the underlying IP rights remain in effect, and must thereafter end. This occurrence is called “failure” of the licensed IP, and is most often seen in the case of patent licensing. Whether a license is perpetual, lasts for the duration of the IP right or has a defined term of years, the license ends with the failure of the underlying IP right.

This being said, if a portfolio of such rights is licensed, then the license (and royalty obligation) may continue until the last-to-expire of such rights (see [Section 24.4](#), discussing package licensing).

EXAMPLE: LICENSE GRANT WITH PERPETUAL DURATION

Licensor hereby grants to Licensee a *perpetual* royalty-bearing right and license under the Licensed Patents to make, use, sell, offer for sale and import Licensed Products in the Territory in the Field of Use.

¹ See Raymond T. Nimmer & Jeff C. Dodd, *Modern Licensing Law* §§ 9.4–9.5 (Thomson-Reuters, 2016–17).

EXAMPLE: LICENSE GRANT WITH DURATION TIED TO IP DURATION

Licensor hereby grants to Licensee a royalty-bearing right and license under the Licensed Patents and Licensed Know-How to make, use, sell, offer for sale and import Licensed Products in the Territory in the Field of Use until the later of (a) the expiration of the last-to-expire Licensed Patent, or (b) the Licensed Know-How is no longer used in any Licensed Product.

A perpetual license (and an accompanying perpetual obligation to pay royalties) is perhaps the most potent when trademarks, trade secrets or know-how are licensed. Unlike patents and copyrights, these IP rights have no scheduled expiration, and their licenses may continue for so long as the rights are maintained (e.g., for so long as a trademark is renewed by the owner, and for so long as a trade secret retains its trade secret status).

An important caveat, however, is that the duration of the license itself need not coincide with the duration of the licensee's obligation to pay royalties. That is, even after a trade secret becomes known to the public, thereby destroying its status as a trade secret, a royalty obligation may continue, as illustrated by the following case involving the famous Listerine formulation.²

Warner-Lambert Pharm. Co. v. John J. Reynolds, Inc.

178 F. Supp. 655 (S.D.N.Y. 1959)

BRYAN, DISTRICT JUDGE

Plaintiff sues under the Federal Declaratory Judgment Act, 28 U.S.C. §§ 2201 and 2202, for a judgment declaring that it is no longer obligated to make periodic payments to defendants based on its manufacture or sale of the well known product "Listerine", under agreements made between Dr. J. J. Lawrence and J. W. Lambert in 1881, and between Dr. Lawrence and Lambert Pharmacal Company in 1885.

Plaintiff is a Delaware corporation which manufactures and sells Listerine, among other pharmaceutical products. It is the successor in interest to Lambert and Lambert Pharmacal Company which acquired the formula for Listerine from Dr. Lawrence under the agreements in question. Defendants are the successors in interest to Dr. Lawrence.

For some seventy-five years plaintiff and its predecessors have been making the periodic payments based on the quantity of Listerine manufactured or sold which are called for by the agreements in suit. The payments have totaled more than twenty-two million dollars and are presently in excess of one million five hundred thousand dollars yearly.

In the early 1880's Dr. Lawrence, a physician and editor of a medical journal in St. Louis, Missouri, devised a formula for an antiseptic liquid compound which was given the name "Listerine". The agreement between Lawrence and J. W. Lambert made in 1881, and that between Lawrence and Lambert Pharmacal Company made in 1885, providing

² The interplay of perpetual royalty obligations and IP misuse is a complex and not entirely settled one. As discussed in [Chapter 24](#), charging royalties for a patented device after the patent has expired constitutes patent misuse (see *Brulotte v. Thys*, 379 U.S. 29 (1964)), yet charging perpetual royalties for an unpatented design (see *Aronson v. Quick Point Pencil*, 440 U.S. 257 (1979)) may be permitted.

for the sale of the Lawrence formula, were entered into in that city. Lambert, and thereafter his corporation, originally engaged in the manufacture and sale of Listerine and other pharmaceutical preparations on a modest scale there. Through the years the business prospered and grew fantastically and Listerine became a widely sold and nationally known product. The Lambert Pharmacal Company, with various changes in corporate structure and name which are not material here, continued the manufacture and sale of Listerine and other preparations until March 31, 1955, when it was merged into Warner-Hudnut, Inc., a Delaware corporation, and the name of the merged corporation was changed to Warner-Lambert Pharmaceutical Company, Inc. The plaintiff in this action is the merged corporation which continues the manufacture and sale of Listerine.

Plaintiff's second amended complaint in substance alleges the following:

Prior to April 20, 1881 Dr. Lawrence furnished Lambert with an unnamed secret formula for the antiseptic compound which came to be known as "Listerine", and on or about that date Lambert executed the first of the documents with which we are concerned here. This document, in its entirety, reads as follows:

Know all men by these presents, that for and in consideration of the fact, that Dr. J. J. Lawrence of the city of St Louis Mo has furnished me with the formula of a medicine called Listerine to be manufactured by me, that I, Jordan W Lambert, also of the city of St Louis Mo, hereby agree for myself, my heirs, executors and assigns to pay monthly to the said Dr. J. J. Lawrence his heirs, executors or assigns, the sum of twenty dollars for each and every gross of said Listerine hereafter sold by myself, my heirs, executors or assigns.

On or about May 2, 1881 Lambert began the manufacture of the formula and adopted the trademark "Listerine." The agreed payments under the 1881 agreement were reduced on October 21, 1881 by the following letter addressed to Lambert by Lawrence:

I hereby reduce my royalty on Listerine from twenty dollars pr gross to twelve dollars pr gross on the condition that a statement of your sales made each preceding month be rendered to me promptly on or before the 10th of each month, and payment of the amount due me on said royalty be made to me or my heirs at the same time. I also hereby waive any demands of royalty on you preceding the 1st of October 1881.

They were again reduced on March 23, 1883 by a similar letter reading as follows:

I hereby reduce my royalty on Listerine from ten pr cent on gross amount of sales to six dollars pr gross, the same reduction is hereby made on my royalty on Renalia. Wishing you great prosperity.

Thereafter Lambert assigned his rights to Listerine and other Lawrence compounds to the Lambert Pharmacal Company and this company on January 2, 1885 executed an instrument assuming Lambert's obligations under these agreements with Lawrence and other obligations on account of other formulas which Lawrence had furnished, in the following language:

J. J. Lawrence of St Louis Mo, having originated & heretofore sold to J W Lambert, the formulae & processes for the manufacture of ... Listerine ... with all the rights & benefits accruing therefrom and has received therefor a monthly royalty from J. W. Lambert, and J. W. Lambert having sold said formulae of Listerine ... to the Lambert Pharmacal Company ..., therefore know all men by these presents that for & in consideration of these facts, the said Lambert Pharmacal Co. hereby agrees and contracts for itself & assigns to

pay to the said J. J. Lawrence, his heirs, executors & assigns, six dollars on each & every gross of Listerine ... manufactured or sold by the said Lambert Pharmacal Co. or its assigns ...

The agreements between the parties contemplated, it is alleged, "the periodic payment of royalties to Lawrence for the use of a trade secret, to wit, the secret formula for" Listerine. After some modifications made with Lawrence's knowledge and approval, the formula was introduced on the market. The composition of the compound has remained the same since then and it is still being manufactured and sold by the plaintiff.

It is then alleged that the "trade secret" (the formula for Listerine) has gradually become a matter of public knowledge through the years following 1881 and prior to 1949, and has been published in the United States Pharmacopoeia, the National Formulary and the Journal of the American Medical Association, and also as a result of proceedings brought against plaintiff's predecessor by the Federal Trade Commission. Such publications were not the fault of plaintiff or its predecessors. The complaint recites the chains of interest running respectively from Lambert to the present plaintiff and from Lawrence to the defendants, and concludes with a prayer for a declaration that plaintiff is "no longer liable to the defendants" for any further "royalties".

Despite the mass of material before me the basic issue between the parties is narrow. The plaintiff claims that its obligation to make payments to the defendants under the Lawrence-Lambert agreements was terminated by the public disclosure of the Listerine formula in various medical publications. The defendants assert that the obligation continued and has not been terminated.

The plaintiff seems to feel that the 1881 and 1885 agreements are indefinite and unclear, at least as to the length of time during which they would continue in effect. I do not find them to be so. These agreements seem to me to be plain and unambiguous.

The payments to Lawrence and his successors are conditioned upon the sale (in the 1881 agreement) and the manufacture or sale (in the 1885 agreement) of the medical preparation known as Listerine which Lawrence conveyed to Lambert. The obligation to pay on each and every gross of Listerine continues as long as this preparation is manufactured or sold by Lambert and his successors. It comes to an end when they cease to manufacture or sell the preparation. There is nothing which compels the plaintiff to continue such manufacture and sale. No doubt Lambert and his successors have been and still are free at any time, in good faith and in the exercise of sound business discretion, to stop manufacturing and selling Listerine. The plain meaning of the language used in these agreements is simply that Lambert's obligation to pay is co-extensive with manufacture or sale of Listerine by him and his successors.

The plaintiff, however, claims that despite the plain language of the agreement it may continue to manufacture and sell without making the payments required by the agreements because the formula which its predecessors acquired is no longer secret. To sustain this position plaintiff invokes the shade, if not the substance, of the traditional common law distaste for contractual rights and duties unbounded by definite limitations of time and argues that absent a construction that the obligation to pay is co-extensive only with the secrecy of the formula, it must be a forbidden "perpetuity" which the law will not enforce. I find no support for the plaintiff's theory either in the cases which it cites or elsewhere.

The word "perpetuity" is often applied very loosely to contractual obligations. Indiscriminate application of the term serves only to confuse. The mere fact that an

obligation under a contract may continue for a very long time is no reason in itself for declaring the contract to exist in perpetuity or for giving it a construction which would do violence to the expressed intent of the parties.

There are contracts in which the promisor's obligation has been expressly fixed to last forever. Such cases mainly arise in the field of real property and are governed by various considerations of public policy which have no pertinence here.

Contracts which omit any point of time or any condition which would terminate the promisor's liability are somewhat different. Where it appears that the parties did in fact intend that the obligation terminate at an ascertainable time, the courts, in effect, will supply the missing clause and construe the contract accordingly.

On the other hand, if it appears that no termination date was within the contemplation of the parties, or that their intention with respect thereto cannot be ascertained, the contract will be held to be terminable within a reasonable time or revocable at will, dependent upon the circumstances.

In such cases the courts are loathe to find that the absence of a terminal point indicates an intention to contract for the indefinite future, and a perpetual obligation will not usually be inferred from the absence of a terminating date or condition. While there is no hard and fast rule, the terminal date or condition of termination will be that to be ascertained from the actual though unexpressed intention of the parties or as a remedy for their neglect. If the parties intend that the obligation be perpetual they must expressly say so.

Contracts which provide no fixed date for the termination of the promisor's obligation but condition the obligation upon an event which would necessarily terminate the contract are in quite a different category and it is in this category that the 1881 and 1885 Lambert Lawrence agreements fall. On the face of the agreements the obligation of Lambert and its successors to pay is conditioned upon the continued manufacture or sale of Listerine. When they cease manufacturing or selling Listerine the condition for continued payment comes to an end and the obligation to pay terminates. This is the plain meaning of the language which the parties used.

Moreover, this is not a case in which the promisor's obligation will cease only on the occurrence of some fortuitous event unrelated to the subject matter of the contract. The obligation here is conditioned upon an event arising out of the very arrangement between the parties which is the subject matter of the contract.

In *Cammack v. J. B. Slattery & Bros.*, 241 N.Y. 39, plaintiff had furnished defendant with a secret process. Defendant's liability to make payments therefor depended upon use. There was held to be no uncertainty as to the term of the contract nor any perpetuity of obligation, but that the obligation to pay continued as long as the defendant used the secret process which it had acquired. The court expressly rejected the defendant's contention that the contract was terminable at will because it provided no fixed termination date.

Nor is there any need to resort to extrinsic evidence in order to ascertain what the intention of the parties was, or what the termination date of the obligation to pay would be, for the agreements themselves indicate the condition upon which the obligation terminates.

There is nothing unreasonable or irrational about imposing such an obligation. It is entirely rational and sensible that the obligation to make payments should be based upon the business which flows from the formula conveyed. Whether or not the obligation continues is in the control of the plaintiff itself. For the plaintiff has the right to terminate its obligation to pay whenever in good faith it desires to cease the manufacture or sale of Listerine. This would seem to end the matter.

However, plaintiff urges with vigor that the agreement must be differently construed because it involved the conveyance of a secret formula. The main thrust of its argument is that despite the language which the parties used, the court must imply a limitation upon Lambert's obligation to pay measured by the length of time that the Listerine formula remained secret.

To sustain this theory plaintiff relies upon a number of cases involving the obligations of licensees of copyrights or patents to make continuing payments to the owner or licensor, and argues that these cases are controlling here. [But all that these cases hold] is that when parties agree upon a license under a patent or copyright the court will assume, in the absence of express language to the contrary, that their actual intention as to the term is measured by the definite term of the underlying grant fixed by statute. It is quite plain that were it not for the patent and copyright features of such license agreements the term would be measured by use.

Paralleling the concept that the licensing of a patent or copyright contracts only for the statutory monopoly granted in such cases is the concept not so frequently expressed that public policy may require a termination of the obligation to pay when the patent or copyright term is ended.

I see nothing in any of the cases which the plaintiff cites dealing with patents and copyrights which supports the theory which plaintiff advances here. Plaintiff has not cited a single case in which the rules of these cases have been applied to a contract involving the conveyance of a secret formula or a trade secret.

In the patent and copyright cases the parties are dealing with a fixed statutory term and the monopoly granted by that term. This monopoly, created by Congress, is designed to preserve exclusivity in the grantee during the statutory term and to release the patented or copyrighted material to the general public for general use thereafter. This is the public policy of the statutes in reference to which such contracts are made and it is against this background that the parties to patent and copyright license agreements contract.

Here, however, there is no such public policy. The parties are free to contract with respect to a secret formula or trade secret in any manner which they determine for their own best interests. A secret formula or trade secret may remain secret indefinitely. It may be discovered by someone else almost immediately after the agreement is entered into. Whoever discovers it for himself by legitimate means is entitled to its use.

But that does not mean that one who acquires a secret formula or a trade secret through a valid and binding contract is then enabled to escape from an obligation to which he bound himself simply because the secret is discovered by a third party or by the general public. I see no reason why the court should imply such a term or condition in a contract providing on its face that payment shall be co-extensive with use. To do so here would be to rewrite the contract for the parties without any indication that they intended such a result.

It may be noted that here the parties themselves made no reference to secrecy in either the 1881 or the 1885 agreements. The word "secret" is not used anywhere in either of them. It is true that I have assumed during this discussion that the plaintiff is correct in its contention that what Lambert bargained for was a "secret" formula. But that in no way justifies the further assumption that he also bargained for continuing secrecy or that there would be failure of consideration if secrecy did not continue.

One who acquires a trade secret or secret formula takes it subject to the risk that there be a disclosure. The inventor makes no representation that the secret is non-discoverable. All the inventor does is to convey the knowledge of the formula or process which is unknown

to the purchaser and which in so far as both parties then know is unknown to any one else. The terms upon which they contract with reference to this subject matter are purely up to them and are governed by what the contract they enter into provides.

If they desire the payments or royalties should continue only until the secret is disclosed to the public it is easy enough for them to say so. But there is no justification for implying such a provision if the parties do not include it in their contract, particularly where the language which they use by fair intendment provides otherwise.

The case at bar illustrates what may occur in such cases. As the undisputed facts show, the acquisition of the Lawrence formula was the base on which plaintiff's predecessors built up a very large and successful business in the antiseptic or germicide field. Even now, twenty-five or more years after it is claimed that the trade secret was disclosed to the public, plaintiff retains more than 50% of the national market in these products.

At the very least plaintiff's predecessors, through the acquisition of the Lawrence formula under this contract, obtained a head start in the field of liquid antiseptics which has proved of incalculable value through the years. There is nothing novel about business being transacted only in a small way at the outset of a contract relationship and thereafter growing far beyond what was anticipated when the contract was made. Because the business has prospered far beyond anticipations affords no basis for changing the terms of the contract the parties agreed upon when the volume was small.

There is nothing in this contract to indicate that plaintiff's predecessors bargained for more than the disclosure of the Lawrence formula which was then unknown to it. Plaintiff has pointed to no principle of law or equity which would require or permit the court gratuitously to rewrite the contract which its predecessors made for these considerations.

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(The Safe Antiseptic)

Listerine is excellent for personal hygiene. A small quantity applied with a damp sponge or cloth will impart to the body a refreshing feeling of cleanliness. Listerine should be your choice of all preparations for the preservation of

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Use Listerine on your tooth brush; then rinse your mouth with diluted Listerine. Listerine will overcome acid conditions in the mouth, and cleanse those surfaces of the teeth which the brush cannot reach. Listerine is the best first aid in nasal accidents. It will relieve skin irritations. It is an agreeable antiseptic after shaving. Sold everywhere in original packages. Round bottles; brown wrapper.

Four sizes: 15c—25c—50c—\$1.00
Made and Owned in America

Lambert Pharmacal Company
Laboratories: St. Louis Toronto

FIGURE 12.1 A 1915 advertisement for Listerine.

If plaintiff wishes to avoid its obligations under the contract it is free to do so, and, indeed, the contract itself indicates how this may be done. The fact that neither the plaintiff nor its predecessors have done so, and that the plaintiff continues to manufacture and sell Listerine under the Lawrence formula with great success, indicates how valuable the rights under the contract are and how unjust it would be to permit it to have its cake and eat it too.

Thus, I hold that under the agreements in suit plaintiff is obligated to make the periodic payments called for by them as long as it continues to manufacture and sell the preparation described in them as Listerine.

Notes and Questions

1. *No termination date.* The court in *Warner-Lambert* reasons “if it appears that no termination date was within the contemplation of the parties, or that their intention with respect thereto cannot be ascertained, the contract will be held to be terminable within a reasonable time or revocable at will, dependent upon the circumstances.” Why wasn’t Warner-Lambert permitted to terminate its royalty payments on Listerine?
2. *Perpetual profit.* In *Warner-Lambert*, the court distinguishes the original license of the secret Listerine formula from licenses of patents and copyrights. Yet the Listerine formula became public years before the case was brought. How does the court justify the ongoing royalty obligation when there is no apparent IP right remaining in effect? How does the court distinguish Warner-Lambert’s license from a typical patent or copyright license? Keep this case in mind when you read *Aronson v. Quick Point Pencil* in [Chapter 24](#).
3. *The rest of the Listerine story.* The court’s 1956 decision in *Warner-Lambert* created a perpetual income stream for those entitled to a share of Dr. Lawrence’s original Listerine royalties. John J. Reynolds, the defendant and holder of the royalty interest at suit, was a New York real estate broker who purchased the royalty interest from Dr. Lawrence’s heirs for \$4 million. As reported in a recent news story:

Reynolds in turn split up the shares and sold them to entities including the Roman Catholic Archdiocese of New York, the Salvation Army, the American Bible Society and Wellesley College. Among those who eventually acquired a stake was former New Jersey Gov. Chris Christie, whose unusual disclosure of nearly \$24,000 in annual Listerine royalty income was a minor news item during his presidential campaign four years ago.³

One of the slices of Reynolds’ original royalty interest currently earns \$32,000 per year. That slice was sold at auction in July 2020 to an anonymous bidder for \$560,000. While it will take almost eighteen years for the royalty interest to pay for itself, the prospect of a perpetual payment stream, and the enduring human malady for which Listerine is one of the key antidotes, apparently made the purchase attractive.

4. *Patterns of conduct.* The court in *Warner-Lambert* notes that “where there is doubt or ambiguity as to the meaning of a contract ... the courts will follow the interpretation placed upon the contract by the parties themselves as shown by their acts and conduct.” In this case, Warner-Lambert and its predecessors paid royalties for the use of Listerine for at least twenty-five years before suit was brought, substantially weakening Warner-Lambert’s

³ Ryan Davis, *Rare Listerine Royalty Auction Tied To 1881 Contract Flub*, Law360, July 21, 2020.

argument that royalties should not be due. But how seriously should courts take the parties' own actions if they are mistaken or contrary to the terms of a written agreement, especially if the time periods involved are substantially less than twenty-five years? In other words, how long should a party continue to profit from the other party's mistakes after it becomes aware of them?

5. *The Listerine name.* Dr. Joseph Lawrence, the inventor of Listerine, named his formulation in honor of Dr. Joseph Lister, the English physician who pioneered the use of antiseptics in surgical procedures.⁴ Interestingly, the name Listerine was not registered as a trademark until 1912. The original registrant was not Dr. Lawrence, but his licensee, Lambert Pharamcal Corp., the predecessor to Warner-Lambert. Thus, the license at issue in *Warner-Lambert* was not a trademark license, as the Listerine trademark was, and still is, owned by the licensee of the formula.
6. *Rights reversions.* In 1958, Truman Capote granted Paramount Pictures the exclusive right to produce a film based on his novella *Breakfast at Tiffany's*. The 1961 film starring Audrey Hepburn and featuring the iconic song "Moon River" became a classic. In 1991, Paramount was forced to negotiate a new license with Capote's estate due to its earlier failure to obtain rights during the renewal term of the novella's copyright. The new agreement provided that if Paramount did not produce a new version of *Breakfast at Tiffany's* by 2003, then all rights in the work (other than Paramount's right to continue to distribute its original 1961 film) would revert to the estate. In 2020, when the estate sought to license the work for a television series, Paramount intervened, claiming that it possessed the television rights to *Breakfast at Tiffany's*. The estate sued, seeking a declaration that Paramount forfeited its rights under the reversion clause of the 1991 contract. *Schwartz v. Paramount Pictures Corp.* (filed Nov. 4, 2020, Cal. Sup. Ct. for Los Angeles Co.).

Such reversions are not uncommon in copyright agreements in the entertainment industry. Below is typical wording for such a clause.

EXAMPLE: REVERSION OF RIGHTS

If principal photography of the Production (which commencement of principal photography Producer does not undertake, and shall not be obligated, to do) does not commence by the date ("Reversion Date") which is [seven (7)] years after the date of Producer's exercise of the Option, then all of the Rights granted to Producer hereunder shall revert to Grantor, provided, however, that Grantor shall have no right, title or interest in or to any screenplays, treatments, outlines or other material created or developed by or for Producer based on the Rights.

Why do you think that licensees and assignees of copyright interests agree to such reversionary clauses? In some cases, the licensor to whom rights revert must repay any purchase price that the licensee has made in order to obtain the reversion. Do you think that this repayment obligation is fair? How might it be adjusted to accommodate the interests of the licensor?

⁴ It is unclear whether Dr. Lister ever gave Lawrence permission to use his name in this manner. See Leonard F. Vernon, *From Surgical Suite to Fresh Breath: The History of Listerine®*, 4(3) *Int'l J. Dentistry & Oral Health* 1, 4 (2018).

7. *Perpetual conflicts.* All too often, the language of license grants is unclear or contradictory, especially when perpetual rights are purported to be granted. Consider, for example, the enterprise software license in *SEI Global Svcs. v. SS&C Advent*, No. 20-1148 (E.D. Pa., Oct. 23, 2020). On one hand, the license granted purported to be “perpetual.” On the other hand, the agreement required annual renewals with fees established every year. When the licensor increased its renewal fee by 40 percent one year and the licensee refused to pay, what result?
8. *Irrevocable licenses.* In some cases the license grant clause specifies that a license is both perpetual and “irrevocable.” Irrevocability is a powerful concept and indicates not only that a license has no natural end date, but also that it cannot be terminated for any cause, even breach by the licensee (see [Section 12.3](#)). For this reason, irrevocable license grants are relatively rare, but can be appropriate, for example, when a license is fully paid-up (i.e., there is no ongoing royalty obligation). When a license is fully paid, the licensee may argue that it should not be at risk of losing the license, for example, due to a breach of a confidentiality or service commitment under the agreement. Those breaches, it could argue, are addressable through monetary remedies, but loss of the license after it has been paid for is too harsh a remedy.

Consider, however, the (not uncommon) situation in which a license is designated as irrevocable, but other provisions of the agreement suggest that it is not. For example, the court in *Fraunhofer-Gesellschaft v. Sirius XM*, 940 F.3d 1372, 1381 (Fed. Cir. 2019), describes the following contractual terms:

[Section 3.1](#) provides that the Master Agreement license is “irrevocable,” stating that “[Fraunhofer] grants to [WorldSpace] and its Affiliates a worldwide, exclusive, irrevocable license, with the right to sublicense, under the MCM Intellectual Property Rights to make, have made, use, have used, sell, or have sold MCM Technology (and products and services incorporating or utilizing the MCM Technology) in connection with WorldSpace Business.”

On the other hand, [section 7.4](#) states that “[n]o termination or expiration of this Agreement shall effect [sic] the rights and licenses granted to [WorldSpace] under [section 3], provided that [WorldSpace] has paid (or has agreed in writing to pay) all of the amounts specified in [section 4] as of the date of termination or expiration.” Fraunhofer argues that WorldSpace has not made the required payments ...

Assuming that Fraunhofer’s representation about WorldSpace’s failure to pay is accurate, how would you rule regarding the survival of WorldSpace’s license after the Master Agreement is terminated?

12.3 BREACH AND TERMINATION FOR CAUSE

Most licensing agreements provide for early termination before the natural expiration of the agreement. The most common cause for termination is breach of the agreement by the other party (a party cannot generally terminate for its own breach).

A breach of contract is broadly defined under [Section 235\(2\)](#) of the *Restatement (Second) of Contracts* as “The failure to perform at the time stated in the contract.” The apparent simplicity of this definition does a disservice to the many complex obligations and requirements of IP licensing agreements, and breaches of such agreements can include not only failures to perform affirmative obligations (e.g., providing services, delivering products or paying royalties) but also violations of covenants such as the obligation to maintain information in confidence or the making of a representation or warranty that proves to be false.

Under common law, a party's breach of an agreement can give the nonbreaching party various rights and remedies including excuse of its own performance, monetary damages, injunctive relief, the right to cover and the right to terminate the agreement. These remedies are covered extensively in most first-year Contracts courses, and we will not dwell on them here, as most licensing agreements expressly call out the remedies available for breach of contract. The most common of these is termination.

EXAMPLE: TERMINATION FOR BREACH

This Agreement may be terminated prior to the expiration of its Term by either party in the event of the material breach by the other party of any provision of this Agreement, provided that the terminating party shall have notified the other party of the alleged breach and such other party shall have failed to cure such breach within thirty (30) days of the giving of such notice.

12.3.1 *Materiality*

Most clauses permitting termination of an agreement for breach require that the triggering breach be "material." In some cases, breaches of particularly important obligations (e.g., major payments or delivery of a critical deliverable such as a prototype or a manuscript) may be called out as material. However, most agreements do not specify the types of breaches that will be considered material.

If a dispute over the materiality of a breach arises, guidance can be found in a variety of sources. Nimmer and Dodd suggest that a "material" breach be defined as any breach other than an "immaterial" one, such that "materiality could simply be used to preclude a party from canceling a contract for small problems of performance."⁵ Corbin, on the other hand, offers a contextual analysis:

Whether or not a breach is ... material and important is a question of degree; and it must be answered by weighing the consequences in the light of the actual custom of parties in the performance of contracts similar to the one that is involved in the specific case.⁶

Below is a more detailed analytical framework provided by the *Restatement*.

RESTATEMENT (SECOND) OF CONTRACTS § 241

In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;

⁵ Nimmer & Dodd, *supra* note 1, at § 11.18.

⁶ 10 Corbin on Contracts § 53.4.

- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Not surprisingly, courts applying these various legal standards reach inconsistent results when assessing the materiality of contractual breaches in the IP licensing context. Even nonpayment of royalties can be deemed to be material or immaterial, depending on the circumstances.⁷ Accordingly, if there are key obligations under a licensing agreement, the parties should specify that, without limiting the generality of the material breach clause, a party's failure to perform those particular obligations will be deemed to constitute a material breach.

As an illustration of the difficulty that parties and courts often have with the question of materiality, consider the following passage from a recent decision:

it is ultimately the materiality of the breaches that was determinative of the issue and, indeed, is necessarily the reason the matters were presented to the jury despite the district court's previous rulings. Although the jury was not presented with an instruction on materiality, given the parties' discussions throughout the trial, the district court's rulings on the various motions throughout these proceedings, the evidence presented, the arguments made to the jury, and the jury instructions read in their entirety, the verdict can be characterized as one determining materiality. The materiality concept was front and center in Rydex's closing arguments; and in fact, the parties discussed issues obviously addressing materiality throughout trial and submitted the district court's holdings regarding Rydex's breaches to the jury, indicating in fact that those holdings did not carry the day in the contract dispute. The jury's conclusion that Graco be awarded \$0.00 in damages as a result of Rydex's breaches, viewed under our favorable standard of review lens, indicates the jury did not find a material failing on the part of Rydex.⁸

12.3.2 Notice

Most termination for breach clauses require that the terminating party give written notice of the breach to the party that is allegedly in breach. This notice allows the breaching party to contest the characterization of its performance as a breach. More importantly, notice usually triggers a breaching party's right to cure the breach (see [Section 12.3.3](#)).

As noted in *Corbin on Contracts*, "Notice within the designed time period is the condition precedent to the effective exercise of the power reserved. If a party who has a power of termination by notice fails to give the notice in the form and at the time required by the Agreement, it is ineffective as a termination."⁹ Accordingly, a party that fails to give a notice of breach/

⁷ Compare *Metabolite Labs. v. Lab. Corp. Am.*, 370 F.3d 1354 (Fed. Cir. 2004) (refusal "to pay royalties is a material breach of the license") with *USAR Sys. v. Brain Works, Inc.*, 897 F. Supp. 163 (S.D.N.Y. 1995) (failure to pay license fee was not a material breach after vendor failed to deliver contracted software).

⁸ *Ryan Data Exch., Ltd. v. Graco, Inc.*, 913 F.3d 726, 734 (8th Cir. 2019).

⁹ 13 *Corbin on Contracts* § 68.9.

termination following the occurrence of such a breach waives its right to terminate for the breach, though it may retain other remedies, such as a claim for damages, with respect to the breach.¹⁰

Notice of termination must be clear and unambiguous. “[W]here the conduct of one having the right to terminate is ambiguous, he will be deemed not to have terminated the contract” (*Maloney v. Madrid Motor Corp.*, 122 A.2d 694, 696 (Pa. 1956)). The need for clarity is often defeated by a party’s misplaced desire not to appear too confrontational or aggressive. For example, in *Mextel, Inc. v. Air-Shields, Inc.*, 2005 U.S. Dist. LEXIS 1281 at *65–66, Mextel allegedly failed to comply with its contractual design and development obligations relating to an electronic controller. The customer sent Mextel a letter purporting to terminate the agreement. According to the court,

The letter listed various problems with Mextel’s design and development of the controllers, including a failure to maintain good design controls and quality work standards, and then threatened that if Mextel “continues to conduct business in this manner, we will have to take appropriate action, which could include termination of Mextel as a developer/supplier as provided under the contract.”

The court held that this letter did not provide adequate notice of termination, as “[a] threat of possible termination in the future does not constitute clear and unambiguous notice.” Accordingly, attorneys should resist the desire of their clients to be overly polite or indirect in their communications when those communications are intended to have legal effect.

One question that is often left unanswered in the termination for breach clause is how soon after the terminating party becomes aware of the breach it must notify the breaching party. In other words, can the terminating party wait for months or years after a breach occurs before notifying the breaching party that it wishes to terminate the agreement? In effect, this would allow the nonbreaching party to hold the threat of termination over the breaching party like a trump card which it could play at any moment.

Another issue that arises is how much, if any, notice the nonbreaching party must give to the breaching party of *termination*. Suppose that the nonbreaching party notifies the breaching party of a breach and the breaching party fails to cure the breach within the allowed thirty- or sixty-day cure period. Is the agreement automatically terminated, or must the nonbreaching party then notify the breaching party of the termination of the agreement?

The answer depends on the wording of the termination for breach clause. It may provide for automatic termination if the breaching party does not cure within the designated cure period. If this is the case, then the nonbreaching party’s initial notice of breach should also be drafted as a notice of termination.

But if, as in the example provided above, the clause gives the nonbreaching party the right to terminate if the breach is not cured, then we must ask how long the nonbreaching party has to issue notice of termination? If the agreement does not specify a time period (and most do not), then the common law must be consulted. As observed by the Federal Circuit in *Fraunhofer-Gesellschaft v. Sirius XM Radio*, 940 F.3d 1372, 1379 (Fed. Cir. 2018), “it is a general rule of contract law that a party exercising the right to terminate [a] contract must give notice within a reasonable time.” This result is sensible, otherwise the nonbreaching party would hold a sword of Damocles over the head of the breaching party for the duration of the contract term.

¹⁰ See *Carleno Coal Sales v. Ramsay Coal Co.*, 129 Colo. 393, 270 P.2d 755 (1954).

12.3.3 Cure

Most licensing agreements allow a breaching party to cure the breach before the other party is permitted to terminate. The cure period is often thirty days, though thoughtful drafters may establish different cure periods for different types of breaches. For example, payment errors may be quicker to cure than failures to achieve technical results.

Some types of licensing agreements, usually online and consumer licenses (see [Chapter 17](#)), do not give the licensee an opportunity to cure its breach. Rather, these agreements purport to be terminated automatically upon the licensee's breach. Though draconian, courts seem to view these automatic termination clauses as enforceable.

In addition, some agreements classify some types of breaches as "uncurable." For example, the public disclosure of a trade secret or the exposure of customer data to a hacker might not be capable of cure. As a result, some agreements qualify the cure language in their termination for breach clauses as follows:

The breaching party shall have a period of thirty (30) days to cure any such breach that is susceptible of cure; breaches that are not susceptible of cure shall give rise to an immediate right to terminate this Agreement.

Another question that arises in the context of breach is *when* a breach is considered to be cured, and who decides whether the cure is adequate. Must the nonbreaching party be satisfied with the cure in order for it to eliminate the right to terminate? If so, the following language is often used:

The breaching party shall have a period of thirty (30) days to cure any such breach to the reasonable satisfaction of the nonbreaching party.

Of course, this qualification gives the nonbreaching party a degree of discretion whether or not to accept a cure. For example, suppose that a biotech firm breaches its obligation to deliver a vaccine to a public health authority because the oral form of the vaccine proves to be ineffective in humans. Can the firm cure the breach by delivering an intravenous form of the vaccine instead? Can the public health authority reject this cure on the basis that its pediatric patient population is terrified of needles?

But if the nonbreaching party does not get to decide whether or not the cure is adequate, then who does? In the end, this question may have to be answered pursuant to the dispute resolution procedures of the agreement or, absent those, by a court.

12.3.4 Excuse of Performance: Dependencies

In addition to giving the nonbreaching party the right to terminate an agreement, a party's breach also provides grounds to excuse the nonbreaching party's performance under the agreement. For example, if one party fails to deliver a technical design or specification to the other, then the other party's obligation to pay for it or to implement that design in a product may be postponed or excused.

This principle has longstanding roots in the common law,¹¹ but parties that are particularly concerned about so-called "dependencies" sometimes adopt express contractual language to reflect the effect on the nonbreaching party.

¹¹ See *Restatement (Second) of Contracts*, § 237 ("it is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time").

EXAMPLE: DEPENDENCIES

Licensor's obligation to deliver the Deliverables specified in Schedule X shall be dependent upon Licensee's provision of the materials and authorizations specified in Schedule Y, and any delay or failure by Licensee to provide such materials and authorizations at the times specified in Schedule Y shall postpone or excuse, as the case may be, Licensee's corresponding obligation to deliver the associated Deliverables.

Notwithstanding the foregoing, any delay by Licensee in providing the required materials and authorizations of more than 30 days beyond the date specified in Schedule Y shall constitute a material breach of this Agreement by Licensee.

Notes and Questions

1. *Milestone failures as breach and termination events.* As discussed in [Section 8.5](#), many exclusive licensing agreements include milestones that the licensee is expected to achieve on its path toward commercialization of an invention. Often, the failure to meet a milestone results in the licensee's ineligibility for a payment tied to the achievement of that milestone. But under some agreements, milestone requirements are not only payment triggers, but affirmative obligations. In these cases, failure to meet a milestone could constitute a breach of the agreement and supply grounds for termination. Under what circumstances might this approach to milestones be appropriate? An alternative approach treats the failure to meet an important milestone as grounds for termination of the agreement, but does not classify such failure as a breach. What are the relative advantages and drawbacks of this approach?
2. *Materiality.* Most licensing agreements do not specify what types of breaches rise to the level of materiality necessary to trigger a termination right. Why not? List five types of contractual breaches in an IP licensing agreement that would almost always be material, and five that would almost always be immaterial.
3. *Breach of a material term versus material breach of a term.* The example above gives a party the right to terminate the agreement upon the other party's uncured material breach of the agreement, which is the most common formulation of the termination for cause clause. But some licensing agreements formulate this clause in terms of a "breach of a material obligation under the agreement." What is the practical difference between these two formulations? Which one would be preferable in your view? See *IGEN Intl. v. Roche Diagnostics*, 335 F.3d 303 (4th Cir. 2003) (upholding the jury verdict finding that Roche's underpayment of royalties and violation of field of use restrictions were breaches of material obligations). But see *Septembertide Publishing v. Stein & Day*, 884 F.2d 675 (2nd Cir. 1989) (publisher's failure to pay one-third of required amounts did not amount to a material breach giving rise to a termination right).
4. *Incurable breaches.* As noted above, the public release of a trade secret is often considered an incurable breach. What other types of breaches of an IP licensing agreement might be considered incurable?
5. *Cure and dependencies.* Suppose that the licensor in the above example fails to deliver materials required by the licensee for its performance within thirty days of the due date. Under the language in the example, this failure constitutes a breach by the licensor. But under the termination for breach clause, each party is given thirty days to cure breaches. Does the licensor thus get an additional thirty days to deliver the required materials? What is the reason that this additional cure period may be allowed?

6. *The limits of dependencies.* Dependencies are generally effective to postpone a party's delivery obligations if the other party has delayed necessary precursor tasks. But parties should not try to expand the scope of dependencies to cover obligations that are not genuinely requirements for the other party to perform. For example, in *iXL, Inc. v. AdOutlet.Com, Inc.*, 2001 U.S. Dist. LEXIS 3784 (N.D. Ill. 2001) (discussed in [Section 9.2](#)), the court chastises a developer for attempting to broaden its customer's dependencies beyond their reasonable meaning:

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."

How does the example dependencies clause above avoid the problem introduced by paragraph 2.2 in the agreement between iXL and AdOutlet?

7. *Escrow of disputed sums.* If the parties disagree over the amounts due under a licensing agreement, it is sometimes advisable for the licensee to pay the disputed amounts into an escrow account administered by a neutral party (e.g., an attorney or accountant). The escrow agent is then instructed to disburse to the licensor the amount that a court or arbitrator determines to be owed. This approach demonstrates the licensee's good faith and its willingness and ability to pay the disputed amount. In *Fantasy, Inc. v. Fogerty*, 984 F.2d 1524 (9th Cir. 1993), the Ninth Circuit held that a licensee who followed this approach did not materially breach a publishing agreement. When would you recommend that a licensee establish such an escrow account? Are there any circumstances when this approach would not be desirable?
8. *Other termination events.* In addition to breach, licensing agreements often contain other events that trigger one or both parties' right to terminate. These include events of force majeure (see [Section 13.6](#)), bankruptcy or insolvency of a party (see [Chapter 21](#)), the merger or change in control of a party (see [Section 13.3](#)), the failure of a party to achieve a milestone payment (see Note 1 above) and the licensee's challenge to the validity of the licensed IP rights (see [Chapter 22](#)). The value of listing these events of termination separately is that they can trigger termination without the need to prove breach of contract. In these cases, a party may terminate without the ability to recover damages for breach. What other nonbreach events of termination might you recommend including in an IP licensing agreement?
9. *Contractual and common law termination.* With or without a contractual termination clause, a party may still have a right to terminate a contract under the common law following the other party's breach. Thus, if the parties wish to eliminate entirely one party's ability to terminate the agreement, they must do more than simply omit that party from a termination for cause clause or omit the clause entirely. Rather, the party must expressly waive its right to terminate, a legal act that may or may not be recognized by a court.
10. *Breaches by sublicensees.* What happens when a sublicensee breaches its sublicense agreement? Clearly, the sublicensor has remedies against the breaching sublicensee, including termination. But does the primary licensor have a remedy against the breaching sublicensee? Should the primary licensor have the ability to terminate a sublicense for breach without

the sublicensor's consent? And should the sublicensee's breach constitute a breach by the licensee of the primary license (i.e., the sublicensor)? Why or why not?

The law is not entirely clear or consistent on these points so, not surprisingly, parties sometimes attempt to address them contractually. How would you respond, as the licensee, to this proposed language in an IP licensing agreement:

Licensee shall have the right to grant sublicenses to one or more sublicensees who have been approved in writing by Licensor in advance, provided, however, that any breach of the terms of any such sublicense by a sublicensee shall be deemed to constitute a material breach of this Agreement by Licensee, as to which Licensor shall have all of its available remedies, including the right of termination.

11. *Licensor's self-help remedies.* In addition to monetary damages, specific performance and termination, licensors of software and other technology products often have recourse to technical measures to address breaches of their licensing agreements. This is the technological equivalent of shutting off a customer's water or electricity for nonpayment of bills. Licensors can embed kill switches, throttles or other electronic disabling devices into their products for activation upon a licensee's breach.

Not surprisingly, licensees have objected to the use of such mechanisms, particularly when the licensor's self-help actions block access to, damage or destroy the licensee's data. Claims have been brought against licensors exercising self-help remedies under a variety of legal theories, including trespass, private nuisance and violations of the Computer Fraud and Abuse Act, 18 U.S.C. § 1030, the Electronic Communications Privacy Act, 18 U.S.C. §§ 2701-10 and other state and federal statutes. In general, courts have upheld a licensor's ability to resort to self-help measures, particularly when the licensee has consented to the use of such measures in its licensing agreement. See *Am. Computer Trust Leasing v. Jack Farrell Implement Co.*, 763 F. Supp. 1473 (D. Minn. 1991) (permitting remote deactivation of software system following licensee's failure to pay required licensing fees).¹²

If you were representing the licensee of a critical enterprise software system, what protections might you include in your licensing agreement with the software vendor to prevent a potentially catastrophic loss of data or interruption of your business?

12.4 TERMINATION WITHOUT CAUSE

In [Section 12.3](#) we considered the conditions under which a party may terminate an agreement "for cause," namely following the other party's uncured material breach. In this section we address contractual provisions that permit parties to terminate their agreements without cause, also referred to as "at will" termination and termination "for convenience" clauses.

EXAMPLE: TERMINATION WITHOUT CAUSE

[Either party] [1] shall have the right to terminate this Agreement without cause upon 30 days prior written notice to the other party.

¹² For a more comprehensive discussion, see Nimmer & Dodd, *supra* note 1, § 11.34 (Electronic self-help remedies).

DRAFTING NOTES

[1] *Parties* – it is not always the case that both parties are given the right to terminate an agreement without cause. This right is often heavily negotiated.

In general, termination without cause provisions allow one or both parties to terminate an agreement on a no-fault basis. Some agreements require that a party exercising its right to terminate without cause pay a termination or “break-up” fee to the other party. The amount of this fee is entirely subject to negotiation, but is often based on the nonterminating party’s loss of anticipated profits due to the termination of the relationship.

In some cases a party subjected to termination by the other party without cause has challenged the validity of the termination without cause provision of the agreement. In *Intergraph v. Intel*, 1995 F.3d 1346 (Fed. Cir. 1999), Intergraph was a member of Intel’s “strategic customer” program, under which Intel provided Intergraph with various special benefits, including advance design information and samples of new versions of Intel’s chips. Intergraph then sued Intel and other Intel customers for patent infringement. In response, Intel exercised its contractual right under the strategic customer program to terminate Intergraph’s participation in the strategic customer program without cause. Intergraph challenged Intel’s termination, alleging, among other things, that the clause was unconscionable and thus unenforceable. In rejecting Intergraph’s claim, the Federal Circuit reasoned as follows:

The district court also ruled that the at-will termination clause was “unconscionable” ... The district court rejected the argument that unconscionability as a ground of contract illegality was intended for consumer protection, and held that “the principle applies with equal force in the commercial field.” We observe, however, that the Alabama courts, like others, have emphasized that “[r]ecission of a contract for unconscionability is an extraordinary remedy usually reserved for the protection of the unsophisticated and the uneducated.” Although Intergraph is a much smaller company than Intel, it is one of the Fortune 1000, and does not plead inadequate legal advice in its commercial dealings. The Alabama Code comments that “The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.” Applying this state law, the Alabama courts have recognized that “it is not the province of the court to make or remake a contract for the parties.”

Trade secrets and other proprietary information and products including pre-release samples of chips are commercial property, and the terms of their disclosure and use are traditional matters of commercial contract. Intergraph does not state that it objected to the mutual at-will termination provision when the contract was entered. Indeed, the district court found that when Intergraph switched [to Intel’s technology, Intel] did not commit ... to provide [Intergraph] a perpetual supply of chips, pre-released chips, or confidential information [and] did not commit ... to any continued or “perpetual business relationship” with Intergraph.

In an agreement relating to confidential information, negotiated between commercial entities, it is not the judicial role to rewrite the contract and impose terms that these parties did not make. Such intrusion into the integrity of contracts requires more than changed relationships. No fraud or deception is here alleged.

Notes and Questions

1. *Who can terminate for convenience?* As noted above, there are situations in which one, but not both, parties to an agreement are given the right to terminate for convenience. What circumstances might justify giving this powerful right to one party but not the other?

2. *Better than breach?* Some licensing agreements may give a party the right to terminate if certain milestones are not met. Yet terminating on that basis and admitting that a milestone was not met could have negative implications for one or both parties. In this case, it might be preferable for a party to have the right to terminate without cause, so that it does not have to publicly disclose a milestone failure. For example, in 2015 Lexicon and Sanofi-Aventis entered into a licensing agreement for worldwide development and commercialization of Lexicon's diabetes drug candidate sotagliflozin. The agreement gave Sanofi-Aventis the right to terminate if "positive results" were not achieved at certain stages of drug development and approval. When Sanofi-Aventis, citing the drug's failure in a clinical trial, exercised its right to terminate in 2019, Lexicon's stock value dropped by 70 percent.¹³ Would Lexicon have been better off by giving Sanofi-Aventis the right to terminate without cause? What limitations might it have wished to put on this right?
3. *Termination payments.* Should all agreements that allow termination without cause include termination payments? Should termination payments be different depending on whether termination is triggered by the licensor or the licensee?
4. *Termination of franchisees.* Section 1-208 of the Uniform Commercial Code provides that "at will" termination of a contract may be permitted only if a party "in good faith believes that the prospect of payment or performance is impaired." The parties' freedom to contract into such a termination at will scenario is thus limited. Likewise, both federal and state laws prohibit franchisors from terminating many franchise agreements (see [Section 15.5](#)) except with "good cause." See, e.g., New Jersey Franchise Practices Act, N.J. Stat. § 56:10-5 (franchise may not be terminated, canceled or nonrenewed "without good cause").¹⁴ Are such protections justified? Why? For more insight into the bargaining dynamics and leverage in the franchise industry, see [Section 15.5](#). Should this type of statutory protection be advisable for other types of IP licensing agreements? Under what circumstances?
5. *Statutory termination.* As discussed in [Section 2.2](#), Note 5, Sections 203 and 304 of the Copyright Act permit an assignor or licensor of a copyright to terminate most copyright assignments and licenses between thirty-five and forty years after they were made. Since its enactment, this statutory termination right has been exercised many times, often by musicians, authors and artists whose works are still popular decades after rights were initially signed away.

12.5 EFFECTS OF TERMINATION AND SURVIVAL

Under the common law, when an agreement is terminated, all executory rights and obligations of the parties end, while the parties' rights and obligations incurred prior to termination may, depending on the circumstances, continue (e.g., the obligation to pay for goods and services delivered prior to the termination).¹⁵ Rather than rely upon the application of such rules, however, most parties to IP licensing agreements prefer to specify the precise effects of a termination. A number of these effects of termination are discussed below.

¹³ Jacob Plieth, *Lexicon and Sanofi Fall Out Over Semantics*, Evaluate Vantage, July 29, 2019.

¹⁴ There are, however, exceptions, particularly when a franchise agreement contains an express clause allowing termination without cause. See *Witmer v. Exxon*, 394 A.2d 1276, 1285 (Pa. Sup. 1978) ("Where there is no explicit termination clause ..., a franchisee indeed has a reasonable expectation that the relationship will not be terminated arbitrarily without cause. However, when the actions of the franchisor are within plain and explicit enabling clauses of the lease, we find it impossible to say that the reasonable expectations of the franchisee have been violated").

¹⁵ See, e.g., *Mextel, Inc. v. Air-Shields, Inc.*, 2005 U.S. Dist. LEXIS 1281 at *54 ("effect of both 'termination' and 'cancellation' of sale of goods means that all executory obligations on both sides are discharged, but any right based on prior breach or performance survives").

12.5.1 *Payments*

Generally, a party will be required to pay for services performed and goods delivered in compliance with an agreement prior to its termination.

EXAMPLE: SURVIVAL OF PAYMENT OBLIGATIONS

Licensor's right to receive all payments accrued and unpaid on the effective date of such termination shall survive the termination or expiration of this Agreement.

12.5.2 *Return of Materials*

There is no inherent obligation on parties to return confidential or proprietary materials after the termination of an agreement. Thus, this requirement must be included expressly if the parties are concerned about post-termination possession and use of such materials.

EXAMPLE: RETURN OF MATERIALS

Upon any expiration or termination of this Agreement, Licensee shall immediately (A) return to Licensor (or, at Licensor's option, destroy and certify in writing to Licensor that it has destroyed) the original and all copies of the Licensor Products, including compilations, translations, partial copies, archival copies, upgrades, updates, release notes and training materials relating to the Licensor Products, in Licensee's control or possession, (B) remove all Licensor Products from Licensee Offerings, (C) erase or destroy all such materials that are contained in computer memory or data storage apparatus of Licensee or under the control of Licensee or its agents, (D) return to Licensor any advertising and other materials furnished to it by Licensor, (E) remove and not thereafter use any signs containing the name or trademarks of Licensor, and (F) destroy all of its advertising matter and other pre-printed matter remaining in its possession or under its control containing Licensor trade names or trademarks.

12.5.3 *Transitional Licenses*

Upon termination of a licensing agreement, unless otherwise specified, all licenses under the agreement automatically terminate. Sometimes, however, there are reasons that licenses should survive for a limited period following termination. One such reason is to give the licensee the right to sell off inventory of licensed products that were manufactured prior to the termination.¹⁶ Sometimes, in order to sell such inventory, it is also necessary to allow the licensee to continue to use any licensed marks and brands in connection with its sales and promotion activities. Finally, particularly in the context of software licensing, it may be advisable to permit the licensee to continue to use the licensed products in order to provide support and maintenance to end user customers. All of these temporary licenses, however, should end within a reasonable period following termination.

¹⁶ Recall that even absent a contractual right to sell off inventory, some courts have recognized an implied license allowing the licensee to do the same. See *McCoy v. Mitsuboshi Cutlery*, 67 F.3d 917 (Fed. Cir. 1995) (discussed in Section 4.4).

EXAMPLE: TRANSITIONAL LICENSES

Upon any expiration or termination of this Agreement, Licensee shall immediately cease all manufacture, use, sale, import, distribution and promotion of the Licensed Products, except that

- a. Licensee may sell, offer to sell, advertise and promote its existing inventory of Licensed Products (“Post-Termination Sales”) on a nonexclusive basis for a period not to exceed sixty (60) days following the effective date of termination (the “Post-Termination Period”); provided, however, that Royalties shall be due and payable on all Post-Termination Sales within thirty (30) days following the end of the Post-Termination Period and shall be accompanied by the report required in Section ___.
- b. Licensee may continue to use labeling and promotional literature bearing the Licensed Marks during the Post-Termination Period only in conjunction with the Post-Termination Sales set forth in subsection (b) above. Upon the expiration of the Post-Termination Period, all use of the Licensed Marks shall cease; all sales and offers to sell, advertising and promotion of the Licensed Products shall immediately cease; and all remaining labeling and promotional literature bearing the Licensed Marks shall be destroyed and its destruction certified by an officer of Licensee.
- c. Licensee shall have the right to retain one copy of and to continue to use the Licensor Products in Object Code Form internally for a period of one year in order to support End User customers who have valid Software License Agreements in effect on the effective date of the termination or expiration of the Agreement.

12.5.4 *Transition Assistance*

In addition to the continuation of licenses, some licensees, particularly users of large enterprise software systems, may require the licensor’s assistance in transitioning to a replacement system if their license terminates prior to the end of its scheduled term. A “transition assistance” clause provides this support.

EXAMPLE: TRANSITION ASSISTANCE

If the term of this Agreement or any Order Schedule is not renewed or is terminated by Licensor other than for Licensee’s breach, Licensor shall, upon Licensee’s written request, continue to make the Software under such a nonrenewed or terminated Order Schedule available to Licensee and shall provide transitional assistance (“Transition Services”) to Licensee to the extent reasonably requested by Licensee to facilitate Licensee’s smooth migration from the Software to that of a replacement supplier. Such Transition Services shall include the delivery to Licensee of all Licensee data in Licensor’s custody or control, provision of historical records of Licensee’s use of the Software, and other services as Licensee shall reasonably request and Licensor shall reasonably agree to provide. Licensee shall pay Licensor an hourly rate of \$___ for the provision of Transition Services hereunder. In no event shall Licensor be required to provide more than ___ person-hours of Transition Services.

12.5.5 Statutory Indemnities

Under the laws of some countries, the termination of an agreement may trigger a payment or other obligation imposed by law. An example arises under the 1986 EU Agency Directive (Council Directive 86/653/EEC), which requires that a licensor or manufacturer that terminates a sales agent in the EU must pay the terminated agent an indemnity or compensation in the range of one year's full compensation. This requirement cannot be waived by contract, and has caught many non-EU principals unawares.

12.5.6 Effect on Sublicenses

As discussed in [Section 6.5](#), a sublicense conveys to the sublicensee a set of rights that a licensee has received from a prime licensor. Unless otherwise agreed by the licensee (sublicensor) and its prime licensor, a sublicense only exists while the underlying prime license remains in force. Thus, absent a special arrangement, when the prime license is terminated, all of its dependent sublicenses also terminate automatically.¹⁷

The automatic termination of sublicenses can be particularly harsh for sublicensees who have no control over, or visibility into, the relationship between the sublicensor and its prime licensor. Thus, when sublicenses under a prime license are anticipated, the licensee sometimes negotiates to protect its prospective sublicensees from a sudden and unexpected termination.

The most common scenario in which this occurs involves software. Consider a firm that provides a large enterprise software package that includes subsystems created by several different vendors. Each of these vendors licenses the software provider to incorporate a subsystem into the software package and to sublicense the subsystem to end users as part of the overall software package. If the license agreement between the subsystem vendor (licensor) and the software provider (licensee) terminates, it would be particularly harsh to terminate each end user's (sublicensee's) license to the entire software package, or even to the subsystem that is embedded inside of it. Thus, software licenses often permit end user sublicenses to continue following a termination of the prime license, provided that the sublicensor assigns those sublicenses to the prime licensor.

EXAMPLE: SURVIVAL OF SUBLICENSES

Following any termination or expiration of this Agreement, each sublicense granted by the Licensee to an End User with respect to the Licensed Software shall survive in accordance with its terms, provided that End User is not in breach of its End User License Agreement and such End User agrees to owe all further obligations thereunder directly to Licensor.

¹⁷ Prior to the Federal Circuit's 2018 decision in *Fraunhofer-Gesellschaft v. Sirius XM Radio*, 940 F.3d 1372, 1380 (Fed. Cir. 2018), which definitively held that "our law does not provide for automatic survival of a sublicense" upon termination of the primary license, several commentators argued that sublicenses *should* survive such a termination. See, e.g., Ridsdale Ellis, Patent Licenses § 62 (3d ed. 1958) ("A sub-license is an independent contract and, therefore, it is not terminated by the termination of the main license, unless specifically so provided") and *id.* at § 63 ("Where a sub-licensee has lived up to the terms of the license it is inequitable that his license should be revoked because the main licensee has failed to do the same, especially where the sub-licensee has made extensive investments on the strengths of his license"); Brian G. Brunsvold & Dennis P. O'Reilley, *Drafting Patent License Agreements* 37 (BNA, 4th ed., 1998) ("An authorized sublicense is in effect an agreement with the [original] licensor. Unless the agreement with the licensee provides otherwise, the sublicense will continue despite the early termination of the license agreement"). See [Section 6.5](#), Note 3, discussing this set of arguments.

In the above scenario, complications arise if the terminated licensee owes obligations such as support and maintenance to its sublicensees. Then, it may be necessary for the prime licensor to permit the terminated licensee to continue to use the licensed software for purposes of continuing to provide such support and maintenance to sublicensees, as contemplated by clause (c) of the above example.

Things also become more complex when sublicensees are more than passive software end users. For example, in biotechnology commercialization arrangements, a biotech company often sublicenses significant rights that it has received from a university to a large pharmaceutical company. Such sublicense agreements often contain numerous obligations of each party, significant milestone and royalty payments and complex allocations of IP. As such, the prime licensor may not wish to assume these arrangements, but instead may prefer to allow a new licensee to forge its own commercial arrangements with sublicensees. Thus, the licensor in such situations often retains the right to decide whether or not to assume particular sublicenses following the termination of the prime license.

EXAMPLE: ASSIGNMENT OF SUBLICENSES

No later than ten days following the termination or expiration of this Agreement, each sublicense that was granted by the Licensee under this Agreement and that is so designated by Licensor shall be assigned by Licensee to Licensor, and Licensor shall assume each of Licensee's rights, duties and obligations thereunder, provided that Licensor's obligations under such sublicense shall be consistent with and not exceed Licensor's obligations to Licensee under this Agreement and provided that such Sublicensee agrees in writing to owe all obligations thereunder directly to Licensor. All sublicenses that are not thus assumed by Licensor shall be terminated automatically.

On the other hand, the pharmaceutical sublicensee may not be willing to enter into a proposed sublicensing agreement unless its sublicensor obtains a commitment from the upstream IP owner to grant it a direct license in the event that the prime license is terminated (Figure 12.2). Such an agreement is called a “nondisturbance agreement” (a mechanism borrowed from the world of commercial real estate).

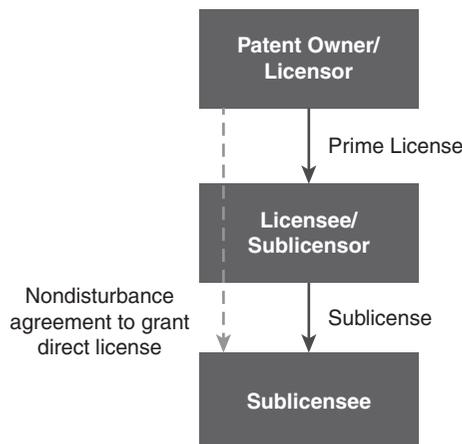


FIGURE 12.2 Operation of a nondisturbance agreement.

12.5.7 Termination of Less than the Full Agreement

In addition to termination of the entire agreement, some agreements provide for the termination of specific portions of an agreement. These portions generally represent large or significant sets of related rights and obligations, such as a project described in a particular statement of work, or a set of licenses relating to a particular field of use. The conditions triggering termination of a portion of an agreement are often similar to the conditions triggering termination of the entire agreement.

Agreements that permit the termination of portions of the agreement must be drafted carefully to indicate what happens to the rest of the agreement once the portion is terminated. In some cases this may be straightforward. For example, a license agreement may grant the licensee exclusive rights in three discrete fields of use. If the portion of the agreement associated with one of those fields is terminated, then the others may continue independently, unaffected by the partial termination. But in many cases there are linkages among portions of an agreement that can become incoherent if attention is not paid to the effect of such partial terminations.

12.5.8 Sole Remedy

Some agreements will specify that termination of the agreement is the “sole and exclusive remedy” for certain events. This type of limitation is particularly risky if it encompasses breaches of the agreement, as it is difficult to predict what damages may arise from any given breach, and termination of the agreement may not make the injured party whole following such a breach. Such sole remedy clauses are more appropriate with respect to termination without cause clauses or terminations based on failure to meet milestones, where there is less likelihood that other damages may flow from the event giving rise to termination.

12.5.9 Survival

In addition to the foregoing, there are a number of standard contractual terms that are routinely designated as surviving the termination of an agreement. These are typically listed in a “survival” section without much elaboration.

EXAMPLE: SURVIVAL

In addition to the foregoing, the following provisions of this Agreement shall survive any termination or expiration hereof in accordance with their terms: Section __ (Confidentiality), __ (Indemnification), __ (Warranties), __ (Limitations of Liability), __ (Compliance with Laws), __ (Dispute Resolution) and __ (Choice of Law).

Notes and Questions

1. *Survival*. Why do you think each of the provisions listed in the survival clause above would survive the termination of the agreement? What does it mean for each of these provisions to survive?
2. *The termination prenup*. Given multiple methods of terminating an agreement and the many ramifications of different types of termination, it is often useful when drafting and

negotiating an agreement to map the different obligations and rights of the parties under different termination scenarios in a large matrix. While this exercise may seem overly negative at the outset, and business representatives often shy away from discussing how their new business relationship may end, as with a good prenuptial agreement, many parties have saved significant headaches by planning the end of their relationship before it begins.