

# Deciding 'Applicable Law'

*With increase in international licensing the determination of applicable law to resolve disputes has become an important issue; suggestions are made*

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Recently, there has been considerable interest in the choice of law problems which relate to international intellectual property licensing. This has resulted, at least in part, from the development of applicable law rules for licenses by the European Economic Community (EEC). Interest has also resulted from the substantial increase in international licensing over the past 10 years, especially licensing involving transfer of technology to developing countries where choice of law is extremely important.

In 1969, the European Economic Community decided to unify its conflict of law rules within the Common Market. The EEC focused on four separate fields of conflict of law rules, one of which was the conflict of law rules relating to personal property, both tangible and intangible, including intellectual property rights.<sup>1</sup> The delegation of the Federal Republic of Germany was assigned the task of drafting the choice of law rules applicable to personal property. Dr. Eugene Ulmer, a former Professor of Law from the University of Munich and Director of the Max-Planck Institute, was given the task of developing proposed rules by the Ministry of Justice of the Federal Republic of West Germany. Dr. Ulmer's proposal, published in 1975, covered the broad field mentioned and included the choice of law rules which go to both the form and the substance of licenses.<sup>2</sup> Giovanna Modiano, of Lalive, and Budin, of Geneva, recently reviewed Dr. Ulmer's proposed rules, as well as various other proposals, and made what he refers to as a proposed solution to the potential problems created by Dr. Ulmer's rules.<sup>3</sup>

This article reviews the basic choice of law rules relating to licenses, the proposals of Dr. Ulmer, and the proposals of those who recommend alternatives to Dr. Ulmer's approach, including the proposed solution of Modiano. In addition, an alternative proposed solution to the potential problems of the previously recommended approaches is presented. License agreements of an international nature (i.e. those involving parties from different nations with intellectual property of one or more countries as well as those involving intellectual property of more than one country regardless of the domicile of the parties), and license agreements of a domestic nature will be discussed.

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## APPLICABLE LAW AS TO FORM

It is a general rule that contracts should take the form governed by either the law which applies to the substance of the contract (Lex Causae), or the law of the place of contracting (Lex Contractus). While such rules are useful in resolving conflict of law questions concerning form rather than substance of an agreement where the forum in which such issue is being resolved is friendly to the application of such rules, it must be noted that many countries are very stringent about the form of license agreements. In fact, many countries require compliance with their own formalities for the enforceability of such licenses, particularly with respect to third parties. It is for this reason that Ulmer includes in his proposal the provision for applicable law as to form. Specifically, Ulmer indicates that the law of the country in which a patent was issued determines the law applicable to the form of contracts that either license or assign such a patent.<sup>4</sup>

Modiano makes the observation that Ulmer's approach clearly diverges from the general principles stated above and that in order to justify his proposal, Ulmer reasons that licensing agreements apply to clearly defined countries and that, therefore, the parties must take into account the rules governing the forms prescribed by those countries. Ulmer notes that the acquisition of intellectual property rights are usually subject to some formal act such as filing, registration, or a grant of protection.<sup>5</sup>

Ulmer also proposes that the question of validity of an assignment or a license is in some circumstances subject to a registration procedure such as the United Kingdom's "registered user" procedure. The law of the country in which the patent has issued, urges Ulmer, not only determines the right of the original licensee against any subsequent grant of the license in contravention of his rights, but it also determines whether registration in a public register or the like is required for that purpose.<sup>6</sup>

Modiano takes exception to the Ulmer proposal because she feels that if the law of the country where the patent was granted is to govern the form of the license, then the possibility exists for the parties to be bound on matters of form by a law which may differ from the one applicable to substantive issues. In addition, Modiano argues that, in every case where the contract covers several countries, the parties will have to respect rules of form which may easily vary from one country to another. (Of course, this latter argument is sometimes overcome by simply having as many documents, i.e. license agreements, as there are countries involved. However, in instances where worldwide rights are granted and patents are held in many countries or, for example, many patent applications remain pending in many different countries, this suggestion

would not be practical.)

Modiano indicates that the Ulmer proposal creates several problems. For example, she indicates that it would unnecessarily create red tape, and therefore cause a loss of time and money to the parties involved. In addition, she feels that it would enable a dissatisfied party the means to contest the validity of an agreement by merely claiming that its form does not meet the rules of a particular country. This could occur despite the fact that the form of the contract may have been deemed valid under the laws of the country to which the parties stated were utilized in the text of the agreement itself, i.e. the applicable law section of the agreement indicating which law shall be used to resolve disputes arising under the agreement.

Further, Modiano objects to the mere requirement of having to indicate exact countries where license agreements are to apply. As mentioned above, worldwide licenses would be very difficult to handle under the Ulmer proposal. Also, as mentioned, the complications would be compounded in those instances where there remain a multiplicity of pending cases or where there is some intention to continue to file on improvements on a worldwide basis. Ulmer's suggestion may further create an anomaly in the case of a license covering only pending patent applications whereby the license specifies applicable law. Once a patent issues on one or more of the pending applications, under the Ulmer proposal, the applicable law as to form may shift from one country to another. One might further query as to what would happen if a patent had subsequently been invalidated on the basis of fraud or mistake and the patent should never have come into existence.

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Modiano observes that the rationale employed by Ulmer with respect to the validity of the industrial property rights is incorrectly applied to the question of validity of the assignment or license which conveys such property rights, i.e. Ulmer appears to confuse the validity of the contract with the subject matter of the contract, form versus substance. Modiano carries this to its logical conclusion—a contract covers the assignment or licensing of a right. If the parties have agreed to such assignment of license, then the contract is valid.

#### Transfer

Further, in some countries, an assignment or a licensing of intellectual property, trademarks, patent rights, know-how, etc., may be contingent upon the entire business to which it relates being transferred or may be part of a necessary transfer of manufacturing rights. Such a transfer which generally occurred in the country where the owner of all of the property is domiciled may have nothing to do with the rule concerning the form prevailing in the various countries where such intellectual property may be registered and where the transfer of all or only part of the business concerned is not a condition for the validity or the assignment of the license.

It is unnecessary to introduce the obligation concerning form required by the law of the nation in which industrial property right is protected, i.e. where the patent issues or where the trademark is registered,

because the form is of importance only when it comes to registration. Such registration is necessary for the protection of the public interest and with respect to actions relating to third parties. Thus, Modiano is correct in her suggestion that Ulmer has taken a requirement relating to matters beyond the mere relationship between the two parties and is utilizing such requirements to interfere with the direct contractual basis under which the parties deal.

#### APPLICABLE LAW FOR SUBSTANTIVE PROVISIONS OF A LICENSE

Although the foregoing section relates exclusively to agreements involving more than one country, either by virtue of the agreement being between parties of two different countries or otherwise by virtue of the location of the intellectual property itself, the question of applicable law concerning substantive aspects of a license if one which relates both to licenses which are international in nature and to licenses which are domestic in nature, particularly in the United States.

Thus, the difficulty of determining the applicable law relating to substantive provisions of a license agreement may arise:

1. When the patents or other intellectual property being licensed relate to more than one country.
2. When the parties themselves are from different countries.
3. When both parties are from a single country and the license is international in nature because the intellectual property being licensed relates to one or more other countries other than where the parties reside.

In addition, difficulties may arise in domestic licensing simply because the parties may prefer laws of different states to be applicable.

In those instances where agreements do not specify what law is to be applied, the determination of applicable law will be made by the courts. However, to enter into a license agreement without specifying applicable law and leaving it to the determination of the courts is extremely dangerous due to the uncertainty of peculiar aspects of contract law which may not surface until there is some contest concerning the agreement. Thus, while it is of some benefit to discuss which law may apply in those instances in which no law is specified in the license agreement, it is urged that all license agreements should specify applicable law.

In those instances where no applicable law is specified in the agreement, the judicial forum may well determine that the license agreement, which is, of course, purely and simply a contract, will be governed by the laws of the state which is most closely connected with the contract. In other words, the laws of the state with which there are most significant ties or in which the party or parties perform the most significant obligations of the contract will apply. For example, in a sales contract, the seller's obligation to deliver goods is considered to be more significant than the purchaser's obligation to pay. As a result, sales contracts which do not specify applicable law are generally determined to be subject to the laws of the state of the seller.

Where license agreements have been considered, the

judicial determination is not unanimous. The EEC Draft Convention, Article 4.2, indicates that the applicable law for contractual obligations will be the law of the state where performance is required which is "characteristic" of the contract. However, there are arguments for the premise that the licensor has the most significant obligation and there are arguments for the concept that the licensee has the most significant obligation. And, of course, some forums prefer to apply the law of the place where the intellectual property is protected or registered (*Lex Rei Sitae*). The *Lex Rei Sitae* approach is not workable where a license agreement includes intellectual property for more than one country.

### Licensor Obligations

Proponents of the concept that the licensor's obligation is the most significant one argue that it is the licensor who must "deliver" the intellectual property to the licensee and that the licensee, like the purchaser in a sale, merely pays the requisite price. Proponents of the concept that the licensee's obligation is most significant argue that it is the licensee who manufactures or has manufactured, and markets and sells the item of commerce and who is covered by the license and is, therefore, performing the most characteristic obligation. One can see that in the case of a sales agreement, once the product is delivered and the purchaser has paid the price, the obligations of both parties are essentially completed, whereas in a license agreement once the intellectual property is delivered, the licensee, in fact, does much more than pay a price. He must, of course, satisfy quality, marketing, accounting, and other obligations under the agreement as well as, in many instances, satisfy the working requirements of the particular country or countries involved; thus, the question of most significant obligation seems to be weighted heavily in favor of the licensee.

Some legal writers such as Troller<sup>2</sup> distinguish between licenses for one country and those for several countries. Troller proposes that even though the most significant obligation of a license is that of the licensor, the performance in most instances by the licensor takes place in the country of the licensee, and thus he says that there is a close tie between the license agreement and the law that protects the industrial property right which is the subject matter of the agreement. He proposes that, in the case of a contract covering only one country, the law of the licensee should apply, but that when more than one country is involved, the law of the licensor should apply in order to avoid the application of many different laws under a single contract.

Further, distinctions are made by scholars in this area between exclusive and nonexclusive licenses. It is argued that where a license has exclusive rights, he is committed either by law or by implication, or both, to exploit the invention and in those cases the law applicable to the agreement should be the law of the licensee. However, in the case of nonexclusive licenses where no exploitation requirement is set forth by law or by contract, then the law of the licensor should apply.

In fact, Ulmer himself makes this distinction. The

first paragraph of the Ulmer draft which relates to applicable substantive law for tangible and intangible property indicates that, with respect to industrial property rights, the law of the country granting the industrial property rights shall determine: a) the validity of an assignment and the licensing of rights; b) the remedies available to a licensee where there is an infringement; c) the form of the agreements relating to the assignment or license; and, d) whether an assignment or license is to be registered in a public register in order to be valid with respect to third parties.

The second paragraph of Article K of the Ulmer draft indicates that the obligation of the person assigning a right or granting a license, i.e. of the licensor, shall be regarded as the characteristic obligation within the meaning of Article 4.2. There shall, however, be a general presumption that contracts under which the assignee or licensee undertakes to exploit the industrial property rights or by which an exclusive license is granted shall be regarded as more closely connected with the state in which the grantee's place of business is located. Where the grantee has several establishments and the contract does not designate one of them, his principal establishment shall be regarded as his place of business.

### Severable

The EEC's Draft Convention on the Law Applicable to Contractual Obligations amended Article 4 since the time Ulmer presented his position to the Convention. Nonetheless, Article 4 as amended continues to support the concept with which it is most closely connected as to its substantive aspect. It further provides that a severable part of the contract that has a closer connection with another country may, by way of exception, be governed by the law of that other country. Although this exception has now been included, it should be noted that the notes of the EEC report on the Draft Convention indicate that the severability must be "exceptional".

The foregoing discussion relates to substantive aspects of international agreements where the agreement does not specify applicable law and it can be seen that no clear, dependable rule of law may be assumed. The foregoing arguments may be relied upon to support a licensor's or a licensee's respective position with respect to interpretation of an agreement when a dispute is presented to a forum in situations where such a license agreement contains no specific provision for applicable law. However, the outcome is uncertain and this predicament could be avoided by merely including a specific provision for applicable law in the agreement.

### APPLICABLE LAW EXPRESSLY PROVIDED FOR IN A LICENSE

Before discussing in detail the choice of law question and express applicable law provisions in license and assignment instruments, it will be useful to consider the definition of "applicable law". First, it should be recognized that many aspects of a license agreement, the relationship between the parties and the conse-

quences of such an agreement, are covered by laws which cannot be changed or ignored or avoided by a contractual provision. Thus, there are, for example, obligations to report license royalty income to tax authorities; obligations to pay taxes; obligations to keep appropriate bookkeeping and accepted accounting practices; obligations with regard to liability, particularly of the party whose negligence may have caused injury or damage either to its own employees, to employees of the other party to the license, or to third parties.

Likewise, export control laws and other specific requirements concerning reporting and/or compliance cannot, in most instances, be contacted away. From this it must be recognized that "applicable law" should be used only to designate the law governing the contractual rights and obligations of the parties. With regard to intellectual property, the validity of a United States patent, for example, should clearly be determined by United States law. Otherwise, it is an impossible task to determine the validity of such patent.

Within the context of this understanding of "applicable law" in general, if two parties to a license or assignment agreement have expressly stated that the law of a particular country is to govern the contract, then most forums will honor that agreement and apply the specified law as may be required. The general rule that the jurisprudence of most states permit parties to choose governing law finds exception when it is contrary to the fundamental policy of that state or when the statute of frauds has been violated. In other words, public policy and inequitable conduct may be bases for altering a provision concerning choice of law, as they may be for altering any provision in an agreement.

#### Reasonable Basis

Although parties to a license agreement may choose a law that has no relationship to either party or to the subject matter of the agreement, there must be some reasonable basis for the choice. Nonetheless, many parties to licenses will specify that the laws of the State of New York, the laws of the State of California, or the laws of the State of Delaware shall apply when, in fact, they have virtually no tie with those states (except, perhaps, with respect to Delaware, which may be the place of incorporation of one or more of the parties). This occurs because many cases have been decided in New York, in California, and in Delaware on questions of commercial law, licensing and related matters. For example, if both parties agree to the laws of the State of New York, recognizing that their tasks will be easier in determining an outcome of a dispute because there will be reliable case law which can be obtained, the courts may accept such express law provisions.

Most often, however, the law of a license agreement is chosen on the basis of some actual connection between the forum of choice and one or more of the parties. The connection may simply be that the law of the country where the license has been granted shall apply or, in the case of multiplicity of countries involved in the grant, that the law of the country which is of most commercial significance and in which the license has been granted shall apply. On the other hand, it is com-

mon for parties to a license or assignment to specify that the law of the country of their corporate headquarters or nationality, if you will, shall apply. This may be a problem where the parties are from different countries or states and both feel very comfortable with their own laws and very uncomfortable with the laws of the other party. In addition, sometimes it is specified that disputes shall be submitted to a particular neutral court such as a Swiss Court or Swiss or French arbitration, or an American arbitration proceeding. Although not essential, it is sometimes specified that the laws of that particular country shall apply. In some instances, the parties may agree that the laws of a particular country will apply based on specific analysis of needs, e.g. for insurance reasons, as where the French law based laws in the State of Louisiana may be particularly advantageous or disadvantageous, or in those cases where other agreements for the same or similar technology have already been entered into between the parties and the laws of some particular country are specified therein, or in the case where language is important. For example, as between a Canadian company and a Vietnamese company, the laws of the country of France may apply. The agreement may be written in the French language.

The difficulty with all of the foregoing is that, in many instances, regardless of all the reasons that may be put forth for one position or another, the parties simply cannot agree on what applicable law shall apply. Sometimes this matter can hold up negotiations and, in fact, be a basis for determining just exactly who among the parties has more to give and more to get in the deal. Substantial bargaining posture can be lost in the early stages of negotiating if one must concede on this point and completely yield to the other party's position concerning governing law.

Fortunately, as you will see below, the question of governing law need not be simply black and white, or a go-no-go type decision. Modiano and her colleagues have proposed various solutions to the problems created by the Ulmer approach to applicable law. We find a fundamental flaw in these various recommendations and offer our own proposed solution to the problem.

#### SOME PRACTICAL PROPOSALS

Modiano dwells upon the concept of the license agreement being substantively interpreted in accordance with the laws of the state of performance of the most significant obligation. She takes exception to those who are proponents of the licensor being the one performing the most significant obligation and argues in favor of the licensee. She indicates that the licensee may be required to exploit the patent and certainly must be involved in the manufacture and/or sale and promotion, advertising and marketing of the products covered by the intellectual property being licensed. She feels that this is the case regardless of whether the license is exclusive or nonexclusive and whether it covers one or more countries. And so she feels that the law of the principal place of business of the licensee should apply. Since the licensee must pay the royalty, and since the licensee has difficulty in making sure that the invention is not the subject matter of older

patents, the licensee is quite often left with very limited or no guarantees against infringement. In addition, licensors often limit the number of lawsuits taken against the potential infringers or they leave it to the licensee to prosecute such infringers at his own risk. In addition, if there is any technical assistance, it's usually performed for the licensee at the licensee's facility. Further, the licensee may be the one who maintains the patents by payment of annuities. All of these reasons cumulatively lead Modiano to the conclusion that the law of the licensee should apply.

The difficulty with this approach is that in negotiating such a posture, the licensor who has the goods which the licensee has decided it needs, may simply refuse to license on the basis of applying the law of the licensee. Thus, while Modiano relies upon a strong and logical analysis to conclude that the law of the licensee shall apply, her analysis cannot be guaranteed to persuade the licensor. This may be particularly true where the licensor is licensing to many different entities, and some perhaps in different countries, and wants its licenses to be governed by its laws and not have different licenses on the same subject matter governed by laws of different countries.

### Compromise

We have found that, in those instances where the licensor and licensee have difficulty in agreeing upon applicable law, a compromise approach is successful and not only solves the difficult negotiating problem with regard to applicable law but also results in a secondary benefit. The compromise involves having the law apply in accordance with the following rule: In any dispute between the parties, the law of choice of the non-moving party shall apply. In other words, the law of the defendant (or respondent) shall apply. For example, if an American company and a French company are entering into a license, e.g. United States Iron and Francois Pacifique, then in the event that Pacifique were to proceed against United States Iron for a breach of the agreement or on some other dispute, the laws of the State of New York, United States of America, may apply; and if United States Iron is the complaining party against Pacifique, the laws of France shall apply.

For the licensee who prefers the laws of his own country to apply and is unable to move the licensor from a position of requiring the laws of the licensor's choice to apply, this compromise is workable. It is far better to know that if you are going to be sued, the laws of your country will apply (and, that if you want to move against the other party, the laws of its forum will apply) than it would be to simply give in to the other party and always have the other party's laws apply. Obviously, the moving party would only be suing in the event that the other party had breached its obligation, leading to the conclusion that, in general, the above rule (law of defendant applies) results in this: For a given obligation in an agreement, the law of the party obligated to perform that obligation will apply. It should be up to each party to expressly state in the agreement the state of the law it wishes to be applicable in those instances where it is the defendant (i.e. obligated party).

This type of arrangement not only resolves the question of applicable law, but also inherently discourages litigation. It encourages settlement of disputes without recourse to the judicial system and this not only keeps many matters out of the courts but also results in substantial savings to the parties. Obviously, if United States Iron wanted to sue Pacifique, United States Iron would think twice about having to pursue such litigation in France. Likewise, if Pacifique wanted to sue United States Iron, it would think twice about doing this when faced with the necessity of having to litigate in the United States.

If you are the licensee and you desire that the laws of your choice govern, you may do well to argue Modiano's analysis to arrive at the conclusion that the licensee clearly has the most significant obligation under the agreement and that, therefore, the laws of the licensee's choice should apply. On the other hand, if you are the licensor, you may argue that you are the owner and transferor of the intellectual property and, like the seller in a sales contract, you are delivering the goods and therefore have the justification for having the laws of your choice apply, especially if you're involved in a multiplicity of licenses, e.g. in many different countries, and desire some semblance of conformity and reliability with respect to your agreements. However, in the final analysis, when there is a stalemate or a clear, unresolved difference of opinion between the parties concerning applicable law, our proposed compromise approach should be the workable solution.

## APPENDIX-SAMPLE APPLICABLE LAW CLAUSES

Goldshieder, Eckstrom's Licensing in Foreign and Domestic Operations<sup>9</sup> proposes a number of model clauses which may be useful in those instances where the parties readily agree on a single applicable law. Among the recommended sample clauses are:

The validity, performance, construction and effect of this Agreement shall be governed by the substantive laws of the State of New York.

In those instances where one wishes to avoid the difficulty of formalities concerning service and jurisdiction, Goldshieder offers the following clauses:

This Agreement is to be construed and is to take effect as an Agreement made in the City of New York, State of New York, United States of America, and in accordance with the laws of that State, and the parties hereby submit to the jurisdiction of the Courts of that State.

The validity, performance, construction and effect of this Agreement shall be governed by the law of the State of New York. The parties hereby expressly submit themselves to the jurisdiction of the Supreme Court of the State of New York for the determination of any controversy whatsoever arising under or in connection with this Agreement and the parties hereby waive personal service of any Summons, Complaint, or other process in any action in the Supreme Court of the State of New York, and agree that all service thereof may be made by registered mail, return receipt requested, to the other party.

Particularly, for our compromise approach, we recommend the following clause:

This Agreement shall be interpreted and governed by, and all differences of opinion which may arise in the signing, implementation, or termination of this Agree-

ment shall be adjudicated according to, the laws of the State of New York, United States of America, if PARTY A is the complainant and PARTY B is the respondent; and by and of the Republic of France if PARTY B is complainant and PARTY A is the respondent; except that questions affecting the construction and effect of any patent shall be determined by the law of the country in which the patent has been granted.

The foregoing clause may readily be modified to include the subject to the jurisdiction provision and the service provision contained in the above quoted Goldshieder model clauses.

NOTES

1. See M. Giuliano and P. Lagarde, Rapport Concernant le

Projet de Convention sur la loi Applicable aux Obligations Contractuelles 4 (EEC III/862/79-FR, Docket No. 173).

2. E. Ulmer, Intellectual Property Rights and the Conflict of Laws 99-112 (1978) (English Translation of E. Ulmer, Die Immaterialgüterrechte Im Internationalen Privatrecht) (1975), Article K (L) (c) at 101.
3. G. Modiano, "Licensing and Conflict of Laws", *Les Nouvelles*, Journal of the Licensing Executive's Society, Volume XVI, No. 1, March 1981, pp. 55-61.
4. E. Ulmer, Supra note 2.
5. Id at 88, paragraph 137.
6. Id at 88, paragraph 138.
7. Draft Convention on Choice of Law in Contracts, Article 4.2, Common Market Law Review 778 (1979).
8. See A. Troller Das Internationale Privat-Und Ziviprozessrecht Im Geiverblichen Rechtsschutz Und Urheberrecht 200 (1952).
9. Goldshieder, Eckstrom's Licensing in Foreign and Domestic Operations, 1980, 14-83 and 14-84.