

Problems of Careless Drafting

By MICHAEL E. MCGURK*



Most favored licensee provision case is example of necessity for careful drafting of document

Has occasionally strayed over the truth. This is particularly apt, when dealt himself off, and proceeds on as though nothing has happened — attributed to Benjamin Franklin

Every now and again a case gets decided that poignantly illustrates the case that must be taken when drafting your license agreements. Although this statement on its face is critically obvious, it does bear repeating from time to time to reemphasize the obvious. The consequences of careless drafting, or a failure to appreciate the underlying contractual obligations imposed by a licensor's license can have profound long-term effects. Hopefully, after reading this article and studying the case that is discussed below, the truth about most-favored-license provisions will not be ignored like the truth alluded to by Mr. Franklin.

A most-favored-license provision in any license, especially where a licensor expects to grant numerous licenses for the licensed technology, needs to be drafted with great care and thought. A broadly drafted and open-ended clause can have profound long term effects. Of course, if you are the licensee, you should do everything possible to avoid including such a provision (especially in your license). Conversely, if you are the licensor, and have any bargaining power at all, you will demand to be treated at least as fairly as the next licensee, if not better.

The pitfalls in a license of a most-favored-license provision are sharply illustrated in the recent Federal Circuit decision in *Stuhlinger-Grohsholtz Koble, n.b.M. v. Hercules, Inc.*, 85 F.3d 629 (Fed. Cir. 1997).

Stuhlinger-Grohsholtz Koble (SGK), the licensor, was found to have breached the most-favored-license provisions of a license it had entered into 30 years earlier. SGK used its licensee Hercules for patent infringement, and Hercules counter-sued for breach of contract stemming from a license agreement between the parties containing (you guessed it) a most-favored-license provision. Hercules argued that, but for the breach, Hercules would have been licensed under SGK patents and that there would have been no infringement. The district court agreed with Hercules. *Stuhlinger-Grohsholtz Koble*, n.b.M. v. Hercules, Inc., 748 F.Supp. 287 (D. Del. 1995), and the Federal Circuit affirmed. *Stuhlinger-Grohsholtz*, 85 F.3d at 630.

The following is a brief summary of the facts. The license-at-issue was a non-exclusive arrangement entered into in 1954 between SGK and Hercules for the manufacture and sale of polyolefins under SGK's "patent applications and patents issued thereon." The most-favored-license provision of the contract read as follows:

If a license shall hereafter be granted by SGK to any other licensor within the United States or Canada to practice the Process or to use and sell the products of the Process under SGK's inventions, Patent Applications or Patents or any others, then SGK shall notify Hercules promptly in the terms of such other license and if so requested by Hercules, shall make available to Hercules a copy of such other license and the same shall be copied, upon demand if made then (30 months after serving the above-stipulated notice, to the benefit of lower royalty rate or rates for its operations hereunder in the country or countries U.S.A. and Canada) in which such later license is effective, as of and after the date such more favorable rate or rates became effective under such other license

but only for so long as and to the same extent and subject to the same conditions that such . . . lower royalty rate or rates shall be available to such other licensee, provided, however, that Hercules shall not be entitled to such more favorable rate or rates without accepting any less favorable terms that may have accompanied such more favorable rate or rates.

Stuhlinger-Grohsholtz, 85 F.3d at 631.

The parties to the license amended the contract in 1962, 1964, and again in 1972. In each instance, the parties expressly reaffirmed the original 1954 license agreement and thereby the most-favored-license provisions. In the 1972 amendment, Hercules was granted a fully paid-up license through December 3, 1980 — the date one of the SGK patents expired — for polypropylene up to a limit of 400,000,000 pounds per year in sales. Hercules was obliged to pay SGK a specified royalty for any sales of polypropylene exceeding that amount. With respect to SGK's patents expiring after December 3, 1980, Hercules possessed the right, upon request, to obtain "a license on terms no more than the most-favored other paying licensee of SGK." 4.

Prior to expiration of Hercules paid-up license through December 3, 1980 SGK granted Amoco a non-exclusive "paid-up" license under SGK's polypropylene patents in the United States. Amoco paid SGK \$4.2 million.

Sometime in 1985, SGK was informed that Hercules had produced over 600,000,000 pounds of polypropylene in 1980 — the royalty-free limit agreed upon between the parties in 1972. Upon inquiry by SGK, Hercules denied that any further royalty payment was re-

*Associate, *Chesgan, Henderson, Fawcett, Gavelle & Dunne*, Washington, D.C.

quired. SCK filed suit for patent infringement in 1986 after Hercules refused any additional royalty payments.

Hercules first learned of the Amicus license in 1987, after commencement of the lawsuit by SCK, and demanded an equitized license retroactive to December 5, 1980. SCK refused, arguing that Amicus was not a "patent license," under the terms of the 1979 agreement. Hercules' request was too late, and Amicus's license was granted as part of a settlement agreement. Hercules counter-claimed for breach of contract when SCK refused. Asserting that it would have exercised its right to obtain a license as Amicus's terms had SCK not breached the requirement to provide notice contained in the most favored license provision by failing to notify Hercules in 1980 of the Amicus license, Hercules argued that it was entitled to a license retroactive to December 5, 1980, upon paying SCK \$1.2 million. As noted above, both the District Court and the Federal Circuit agreed with Hercules.

It is the author's opinion that the results reached by the District Court and Federal Circuit are correct and appropriate under the facts of this case. Indeed, SCK had a formidable uphill battle given the fairly clear and unambiguous language of

the original license.

This case is interesting, not so much because of the specific facts or the particular result, but because of the very favorable most-favored-license provision negotiated by Hercules. SCK's management likely took of the favorable terms granted to Amicus as part of a settlement agreement, and did not want those terms to be extended to Hercules. Unfortunately for SCK, the most-favored-license provision left little room for maneuvering. This case illustrates, on the one hand, the care that must be taken when a licensee drafts a most-favored-license provision to avoid the result of this case, and, on the other hand, the benefits that may accrue to a licensee that is able to negotiate a very broad most-favored-license provision.

It certainly would be easy to chastise SCK for allowing such a broad provision in a license and, at the same time, easy to applaud Hercules for obtaining such a broad provision, but that is not the real objective of this article. Rather, the SCK case illustrated the pitfalls and benefits of such a provision. In hindsight, and without specific knowledge of the facts surrounding the original negotiations, the obvious policies for SCK would have been to include a time limit or like-

ness limitation into the license. SCK also could have limited that the most-favored-license provision be limited to specific patents and/or pending applications. Moreover, as noted above, SCK agreed to the terms of its license with Amicus to settle a dispute — not really a willing licensee willing license negotiation. Accordingly, a provision limiting the scope of a most-favored-license clause to modifications related license would have been appropriate.

Merely forcing quarterbacking is easy. Negotiating and drafting license agreements, on the other hand, can present many challenging and difficult issues, the resolution of which is likely to be influenced by the negotiating strengths of the parties. The most-favored-license clause is no exception and should be approached with great care in any license. If you are a licensee, the best advice is to avoid its use. If you can't avoid its use, make sure the clause is narrowly tailored to avoid the long term commitments created in the SCK case. If you are the licensee, avoid for the stars and make sure that any time the licensee agrees to more favorable terms with another licensee that you have an absolute right to be notified of and receive the most favorable terms.