

Arbitration Questions To Consider In Patent License Disputes

By **Thomas Creel** (May 1, 2019, 5:32 PM EDT)

Let's say two entities entered into a patent license agreement years ago. Everything has been going wonderfully: The patentee has been receiving royalties, and the licensee has been selling its product without fear of an infringement suit. But now things are not going so well. Several disputes have arisen. The license agreement contains an arbitration clause. Are all the disputes arbitrable, or must some be tried in court? And who decides such questions: an arbitrator or a court?



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Two recent litigations address some of these questions. In *Henry Schein Inc. v. Archer & White Sales Inc.*, the district court found that an antitrust claim was not arbitrable because such an assertion was “wholly groundless.”^[1] The U.S. Supreme Court of the United States rejected this “wholly groundless” test, holding that the courts must respect an agreement in which the parties have agreed to let the arbitrator decide what is arbitrable and what is not.

In *HTC America Inc. v. Ericsson Inc.*, the U.S. District Court for the Eastern District of Texas addressed several arbitration issues relating to patent licenses. That litigation concerns, among other things, so-called “FRAND” patent licenses. These are licenses in which standard-essential patents for a certain industry are licensed on fair, reasonable and nondiscriminatory terms. Litigation was brought by a licensee claiming the terms in existing licenses as well as those in proposed licenses were not FRAND. The licenses contained arbitration clauses.

The district court severed and stayed claims that the existing licenses violated the antitrust laws. It referred these antitrust claims to the arbitrator to decide their arbitrability. Thereafter, the court refused to do the same for the licensor's counterclaims. It rejected an argument that the Schein case required the arbitrator to decide the arbitrability of these claims. It noted that the licensee had basically involved the judicial process. The licensee had completed discovery and filed two motions relating to the counterclaims before filing the motion to refer the counterclaims to arbitration.

These two recent district court decisions help to clarify the contractual requirements of arbitration in antitrust claims. However, there are still details in the process to determine the arbitrability of disputes involving patent licenses that must be further illuminated.

Which Disputes Are Arbitrable When a Patent License Contains an Arbitration Clause?

Jurisdiction of disputes in arbitration is strictly a contractual matter as to what disputes the parties agreed would be arbitrated. The specific language of the arbitration clause controls.

Little thought is normally given to the potential ramifications of the specific language of an arbitration clause that it is inserted in the license. Therefore, rarely is the language of an arbitration clause a topic of negotiation when drafting a license agreement. The usual procedure is to take a standard clause from one of the arbitration organizations and insert it at the end of the agreement.[2]

Typical arbitration clauses use language such as “disputes arising out of the agreement are subject to arbitration” or “disputes relating to the contract are arbitrable,” or some combination of such language or similar.

An example of a typical license dispute is whether a particular product is subject to the required royalty payment in the license. That pretty clearly “arises out of” or “relates to” the license agreement.[3] But what about a claim that the license was fraudulently induced? Such activities occurred before the license was even in existence. Does that dispute “arise out of” or “relate to” the license? Is it arbitrable? Or what about a claim that the patent licensee is using a licensor’s unlicensed trade secret in producing the patent-licensed product or that the licensee is violating antitrust laws?

What Is the Breadth of "Arising Out Of" and "Relating To" in an Arbitration Clause?

How broad is the scope of the terms “arising out of” and “relating to”? Unfortunately, there is no clear answer. It may well depend on the law of the particular jurisdiction.

Arising Out Of

The use of “arising” language has been determined by some courts to be broad and encompass many types of disputes.[4] Conversely, such language has also been found to be narrow and cover only those disputes “relating to the interpretation and performance of the contract itself.”[5]

For example, the U.S. Court of Appeals for the Ninth Circuit case of *Tracer Research Corp. v. National Environmental Services Company*[6] relied on the earlier Ninth Circuit case of *Mediterranean Enterprises Inc. v. Ssangyong Corporation*[7] for its finding of this narrowness standard. In *Mediterranean*, the language was “arising under.” In *Tracer*, the court said that the *Mediterranean* court’s holding “narrowly circumscribes the interpretation” to be given the clause before the *Tracer* court.[8] *Tracer* also cited other cases supporting its narrow reading.[9]

Relating To

“Relating to” is generally broader than “arising under.” The *Tracer* court distinguished “arising hereunder” from “relating to,”[10] and the court in *Mediterranean* found the following: “We have no difficulty finding that ‘arising hereunder’ is intended to cover a much narrower scope of disputes” than “relating to.”[11]

What Is the Arbitrability of Disputes Sometimes Raised in Connection With Patent License Agreements?

Validity of a Licensed Patent

If the licensor asserts a claim for royalties due, can the licensee raise invalidity of the licensed patents? Previously, there were cases establishing that the licensee was estopped from doing so. But the Supreme Court found in *Lear Inc. v. Adkins*[12] that the licensee could raise patent invalidity as a defense to such a claim, even while it maintained its position as a licensee. There was also case law that a patent is invested with a public interest such that only courts could handle invalidity disputes. This changed in 1982 with the passage of 35 U.S.C. Section 294. That provision established that the validity of patents may be arbitrated.

And they have been. See, e.g., *AbbVie Inc. v. Novartis Vaccines and Diagnostics Inc.*: "Novartis has provided a reasonable interpretation of the license agreement — i.e., that patent validity is an issue to be arbitrated under the broad arbitration provision and there is no exclusion-from-arbitration provision for patent validity. The [Federal Arbitration Act's] presumption in favor of arbitration, embodied in § 294(a), applies." [13]

Fraud in the Inducement

The Supreme Court has addressed this issue. In *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, the court stated that "the agreement to arbitrate '[a]ny controversy or claim arising out of or relating to this Agreement, or breach thereof' ... is easily broad enough to encompass Prima Paint's claim that both execution and acceleration of the consulting agreement itself were procured by fraud." [14]

In the earlier case of *In the Matter of the Petition of Kinoshita & Co. Ltd.*, the Second Circuit found such a dispute was not arbitrable where the arbitration clause was "arise under." [15] See also *ASUS Computer International v. Interdigital Inc.*, where an arbitration panel found a fraud in the inducement claim arbitrable in a clause using "arising under" language.

Trade Secret

Sometimes a claim is made that a patent licensee is unlawfully using a trade secret of the patent licensor. Is that arbitrable?

In *Tracer*, a patent license had been terminated. Thereafter, the licensor claimed that the former licensee continued to use trade secrets and confidential information obtained from *Tracer* under the terms of the parties' licensing agreement.

The court first held that the misappropriation of trade secrets count of *Tracer's* complaint was a tort claim. The court found that the fact that the tort claim would not have arisen "but for" the parties' licensing agreement is not determinative. It said that, if proven, defendants' continuing use of *Tracer's* trade secrets would constitute an independent wrong from any breach of the licensing and nondisclosure agreements. Therefore, it did not require interpretation of the contract and was not arbitrable under the court's previous narrow interpretation of the meaning of "arising out of" language in *Mediterranean*.

Similarly, in *SanDisk Corporation v. SK Hynix Inc.*, a trade secret claim was found not to be arbitrable under the arbitration clause in a patent license agreement. [16] There, the court found that the alleged trade secret theft was unrelated to the patent license agreement. The licensee hired one of the licensor's employees during the term of the license. That employee stole some trade secrets from the licensor and brought those with him to his new employer, the licensee. The court found that "it is not conceivable that the alleged theft of trade secrets" could relate to the patent license agreement.

containing the arbitration clause. The court noted that neither party claimed that the licensee obtained the trade secrets via the license agreement.

Antitrust

As with patents, there was a time that antitrust claims were not thought to be amenable to arbitration. They were imbued with a public interest such that nonjudicial officers should not decide such matters, which were thought to be too complex to be handled in an arbitration context. However, the Supreme Court ruled in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*[17] that potential complexity did not demonstrate that an arbitral panel could not handle an antitrust matter and that antitrust disputes could be arbitrated.

Although *Mitsubishi* involved arbitration in an international transaction, the Supreme Court has not limited *Mitsubishi* to international arbitrations. For instance, it has subsequently cited *Mitsubishi* without distinguishing between domestic and international arbitrations.[18]

Courts have sometimes found antitrust claims arbitrable and sometimes not, depending on the type of antitrust violation alleged and the exact language of the arbitration agreement. Compare *Schein*, where the lower court found arbitrability of the antitrust claim to be “wholly groundless,” with *JLM Industries Inc. v. Stolt-Nielsen SA*. [19] In the latter case, the appellate court reversed a lower court order finding such a claim not arbitrable: “We believe that *Mitsubishi*, *Genesco*, and *Kerr-McGee* provide a firm basis for the conclusion that *JLM*'s claims regarding a conspiracy among the Owners in violation of the Sherman Act are arbitrable.” The clause there was “arising out of.”

In patent license cases, courts have found arbitration of antitrust claims to not be wholly groundless. See, e.g., *InterDigital Technology Corporation v. Pegatron Corporation*: “*Pegatron*'s Sherman Act counterclaim involves the PLA [patent license agreement]. Because the Sherman Act counterclaim involves the PLA, *InterDigital*'s assertion that the counterclaim falls within the PLA's arbitration agreement is not wholly groundless.” [20] The clause there was “arising under.”

And in *ASUS Computer International v. InterDigital Inc.*, [21] that court likewise found the antitrust claim to be not wholly groundless. It therefore sent the arbitrability question to the arbitration panel for determination. The arbitration panel thereafter found the claim for violation of Section 2 of the Sherman Act not arbitrable. The clause there was “arising under.” [22]

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[1] *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 2019 WL 122164, 586 U.S. ___, slip opinion page 3 (Jan. 8, 2019). The agreement containing the arbitration clause was for distribution of dental equipment.

[2] One such clause is the JAMS Standard Arbitration Clause for Domestic Commercial Contracts:

Any dispute, claim or controversy arising out of or relating to this Agreement or the breach, termination, enforcement, interpretation or validity thereof, including the determination of the scope or applicability of this agreement to arbitrate, shall be determined by arbitration in [insert the desired place of arbitration] before [one/three] arbitrator(s). The arbitration shall be administered by JAMS pursuant to its Comprehensive Arbitration Rules and Procedures [and in accordance with the Expedited Procedures in those Rules] [or pursuant to JAMS' Streamlined Arbitration Rules and Procedures]. Judgment on the Award may be entered in any court having jurisdiction. This clause shall not preclude parties from seeking provisional remedies in aid of arbitration from a court of appropriate jurisdiction.

[3] See, e.g., *TiVo Inc. v. Goldwasser*, 560 Fed. Appx. 15 (2nd Cir. March 17, 2014), and *Kvaerner Oilfield Products, Inc. v. Cooper Cameron Corporation*, C.A. No. H-05-0992 (S.D. Texas, Houston Division June 26, 2007).

[4] See, e.g., *McLaughlin v. McCann*, 942 A.2d 616, 626 (Del. Ch. 2008) (finding "arising under" language in an arbitration agreement to provide "for arbitration of a wide array of potential claims"); *BAYPO Limited Partnership v. Technology JV, LP*, 940 A.2d 20, 21, 23 (Del. Ch. 2007) (finding "arising under" language in an arbitration agreement to be "broadly worded"); *West IP Communications, Inc. v. Xactly Corp.*, No. N13C-06-052 DCS, 2014 WL 3032270, at *7 (Del. Super. Ct. June 25, 2014) (finding "arising from" language in an arbitration agreement to be "broad language").

[5] "[A]rising out of" is equivalent to "arising under." *Tracer*, *infra*, at 1295.

[6] *Tracer Research Corp. v. National Environmental Services Company*, 42 F.3d 1292, 1295 (9th Cir. 1994).

[7] *Mediterranean Enterprises Inc. v. Ssangyong Corporation*, 708 F.2d 1458 (9th Cir. 1983).

[8] 42 F.3d at 1295.

[9] See also the later Ninth Circuit case of *Cape Flattery Ltd. v. Titan Maritime, LLC*, 647 F.3d 914, 921, 922 (9th Cir. 2011). There, the court recognized that other courts had not followed the Ninth Circuit's narrow interpretation of such language. Nevertheless, the *Cape Flattery* court followed precedent in the Ninth Circuit and found such language was subject to a "narrow interpretation." *Id.*, 647 F.3d at 923.

In *EFund Capital Partners v. Pless*, 150 Cal.App.4th 1311 (2007), a California state court found that the *Tracer* and *Mediterranean* decisions represented a "distinctly minority analysis."

[10] 42 F.3d at 1295.

[11] 708 F.2d at 1464.

[12] *Lear Inc. v. Adkins*, 395 U.S. 653 (1969).

[13] *AbbVie Inc. v. Novartis Vaccines and Diagnostics, Inc.*, 17-cv-01815-EMC (N.D. Cal. Aug. 31, 2017).

[14] See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 406 (1967).

[15] 287 F.2d 951 (1961).

[16] SanDisk Corporation v. SK Hynix Inc., 84 F.Supp.3d 1021, 1032 (N.D. Cal. 2015).

[17] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., 473 U.S. 614 (1985).

[18] See, e.g., Green Tree Financial Corporation-Alabama v. Randolph, 531 U.S. 79, 89, 121 S.Ct. 513, 148 L.Ed.2d 373 (2000) (recognizing that Sherman Act claims can be appropriately resolved through arbitration); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28, 111 S.Ct. 1647 (1991) (noting that the Supreme Court had previously held that "claims under [the Sherman Act] are appropriate for arbitration"); Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 239-41, 107 S.Ct. 2332 (1987) (noting that Mitsubishi addressed international transactions only, but applying the Mitsubishi analysis to arbitration of RICO claims since they are "no different from the federal antitrust laws," without distinguishing between domestic and international antitrust claims).

[19] JLM Industries Inc. v. Stolt-Nielsen SA, 387 F. 3d 163, 175 (2d Cir. 2004).

[20] InterDigital Technology Corporation v. Pegatron Corporation, Case No. 15-cv-02584-LHK (N.D. Cal. Jan. 20, 2016).

[21] ASUS Computer International v. InterDigital, Inc., Case No. 15-cv-01716-BLF (N.D. Cal. Dec. 20, 2018).

[22] Case No. 15-cv-01716-BLF (N.D. Cal. Sept. 4, 2015).