

**A CRITIQUE OF ARTICLE 7 - INTELLECTUAL PROPERTY MATTERS -  
OF THE ABA'S MODEL SOFTWARE LICENSING PROVISIONS WHERE  
LICENSED TECHNOLOGY IS OR MAY BE COVERED BY A PATENT**

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## I. INTRODUCTION

### A. Background

The Proprietary Rights Committee of the State Bar of Michigan critiqued the License Grant Clause of the ABA's Model Software Licensing Provisions ("Model Provisions") in its 1998 report. This year's Committee critiqued Article 7 - Intellectual Property Matters - of the Model Provisions. Article 7 seeks to cover situations where licensed software may be covered by a patent. Such situations may arise more frequently in the future due to the recent increase in the number of software patent applications being filed in the U.S. Patent and Trademark Office.<sup>1</sup>

Also, the existence of a software license agreement or even a finding of an implied software license may be a complete defense to a patent infringement claim.<sup>2</sup>

The sections of the Committee's 1998 report which describe the Model Provisions, a particular fact situation and five different licensing situations related to the fact situation are reproduced here so the reader can more readily understand the impact of Article 7, as well as the ABA and Committee Commentaries.

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1. As reported at 57 BNA's PTCJ 114, the U.S. Court of Appeals for the Federal Circuit affirmation of the patentability of a data processing system for mutual funds (*i.e.*, *State Street Bank & Trust v. Signature Financial Group, Inc.*, 47 USPQ2d 1596 (CAFC 1998)) has triggered a "boom" in patent applications for business method-related software.

2. *Apple Computer, Inc. v. Articulate Systems, Inc.*, 44 USPQ2d 1369 (N.D. Cal. 1997); *Wang Labs, Inc. v. Mitsubishi Elecs. Am., Inc.*, 103 F.3d 1571, 41 USPQ2d 1263 (Fed. Cir. 1997) (Implied License).

**B. ABA'S Model Software Licensing Provisions**

Working Draft 3.0 of the Model Software Licensing Provisions (“Model Provisions”) was released in March, 1992. These Model Provisions were a project of the Committee on Computer Software of the ABA Section on Patent, Trademark, and Copyright Law and are designed to be incorporated by reference, in their entirety, in a software license agreement. The Model Provisions set forth a number of common and/or customary terms and conditions to govern a software license relationship in the absence of the parties' agreement otherwise. These terms and conditions represent synthesis of many software license agreements negotiated by big and small companies.

The Model Provisions set out express definitions for a number of standard terms commonly used in the software industry. The provisions also define some shorthand expressions in the interest of promoting a standard and convenient “lingua franca” for license drafters. Incorporation-by-reference can thus allow drafters to state quickly and succinctly many of the intentions of the parties, thus reducing the transaction costs of the license agreement.

The basic agreement document is divided into 10 Articles covering broad aspects of a software license relationship, including:

- Article 1: Creation of license relationship-grant clause, payment of License Fee;
- Article 2: Start-up activities, e.g., delivery and installation;
- Article 3: Operating provisions, e.g., single-user restrictions, movement of licensed copies;

- Article 4: On-going LICENSOR support, e.g. telephone support, routine maintenance;
- Article 5: Procedures for correction of errors in the licensed software;
- Article 6: Performance-type warranties (including a no-virus warranty) and remedies;
- Article 7: Intellectual property matters (including a non-infringement “knowledge rep”);
- Article 8: Risk allocation (e.g., exclusion of consequential damages);
- Article 9: Breach and termination provisions;
- Article 10: Administrative and general provisions.

Several of the above articles have optional “snap-in” provisions. These provisions have an “s” before their section numbers. For example, Article 2 can be augmented with detailed “snap-in” provisions for custom development of software; Article 4 can be supplemented with “snap-in” provisions for periodic maintenance fees, maintenance releases, and the like. Extensive work went into integrating and coordinating these provisions (and their arrangement in numerical sequence) to be readily mixed and matched in this way. Commentary immediately below the provisions provided by the ABA Committee briefly explains some of the motivations behind and/or implications of these provisions. This Committee's commentary immediately follows the ABA commentary to directly critique these provisions and to indirectly critique the ABA commentary.

### C. Fact Situation

The early days of the Internet were funded largely by grants from the National Science Foundation. On Wednesday, December 2, 1992, the National Science Foundation Network (NSFNET) was de-commissioned. NSFNET was a nationwide network of dedicated 56kbps phone circuits that were replaced by 1.5Mbps (T1) circuits during the course of the NSFNET project. In 1992, the NSFNET which was based on twisted copper wire ceased to exist and the new 45Mbps fiber-optic cable network marked the end of an era.

Since the commercialization of the Internet in 1992, worldwide thirst for Internet bandwidth has been seemingly unquenchable. Phone companies have installed high-capacity fiber-optic cable in an attempt to meet the high demand. As more fiber is installed to carry the data, the problem shifts to the ability of the routers at each end of the fiber to handle the massive number of packets of information. Routers are responsible for directing packets of data so that they can most effectively reach their Internet destination.

The speed of light transmission of data over fiber-optic cable strands is limited by the rate at which data bits can be stored and processed by routers. Capacity of fiber-optic cables can be increased to terabit transmission rates through manipulation of the wavelengths of light without violating the laws of physics. Regardless of the ultimate transmission rate of data over fiber, the routers must be capable of processing the data at phenomenally high transmission rates.

\$1.8 billion will be spent this year on research by just five router manufacturers: Cisco, Bay Networks, Inc., Ascend Communications, Inc., Fore Systems, Inc., and Newbridge Networks Corp. Uunet and other large Internet providers are also investing in start-up

companies such as Juniper Networks, Inc., which is developing a router that is capable of directing one trillion bits of data per second.

A router is typically a combination of both hardware and software. Future advances in router technology will likely include faster hardware circuit designs which may also be implemented in software.

Alternatively, new routing algorithms which are developed in software can be implemented in electronic circuitry in order to increase speed. In other words, the control logic by which the router operates may be implemented in software with conventional hardware or special purpose hardware or electronics. A router manufacturer may wish to retain patent rights on hardware implementations of routing algorithms, but may also want to license the software to companies it does not compete with in order to provide an additional source of revenue.

The software that the manufacturer wishes to license may need to be further developed in order for the Licensee to use and/or market it. Such further development may be done solely by the Licensor, the Licensee or together.

For purposes of this report, it is assumed that the Licensor-Developer has come up with a new concept or approach for doing data routing. Software which runs on a general purpose computer has been developed to implement that concept. Hardware to implement the concept may or may not be in existence.

#### **D. Five Different Licensing Situations**

The first licensing situation closely resembles a conventional software license situation where the LICENSEE has the right to manufacture and distribute the software which

typically runs on a general purpose computer. It is for software only with no right to modify. Consequently, only the object code of the software changes hands. Rights under any patent are licensed only to the extent necessary to allow the Licensee to manufacture and distribute the object code.

In the second licensing situation, the Licensee is to get the rights granted in the first situation, but also the right to make one or more derivative works of the original program. The Licensee will typically receive some source code of the program to make such modifications. No other use of the source code is contemplated.

The Licensee obtains maximum rights in the third licensing situation. The Licensee gets source code, all documentation that the Licensor has in its possession, and even any related hardware. The Licensor grants full patent and software licenses to the Licensee to permit the Licensee to do most anything it wants to do to fully exploit the technology, even to the extent of making hardware implementations of the concept.

In the fourth licensing situation, the Licensor begins to cut back on the software part of the license with increasing focus on the patent part of the license. Any software given to the Licensee is highly restricted in its use. For example, any software given may be given solely for study purposes. In other words, the Licensee can only use the provided software to guide it in writing its own software. In such a situation, the Licensor is attempting to limit its liability in any future products liability lawsuit involving the resulting software developed by the Licensee.

The fifth and final licensing situation closely resembles a conventional patent license where no software, either in source or object form, is transferred from the Licensor to the

Licensee. The Licensee, however, is typically free to exploit or develop the technology in either hardware or software.

## **II. ARTICLE 7 - INTELLECTUAL PROPERTY MATTERS**

### **A. 701. Non-Infringement Knowledge Representation**

1. 701.1 Knowledge Representation re Non-Infringement. LICENSOR makes a Knowledge Representation to LICENSEE, **BUT DOES NOT WARRANT**, that the Exercise of License Rights pursuant to this Agreement will not infringe any valid and subsisting Intellectual Property Right owned by Persons other than the LICENSEE or an Affiliate of LICENSEE.

#### **ABA Commentary**

Only a no-knowledge representation about the absence of infringement problems is made, not an outright warranty of non-infringement. Licensor is nevertheless required to defend against infringement charges pursuant to Section 702. Of course, Licensee may wish to negotiate for a outright warranty, thus putting any duty to investigate squarely on Licensor.

This no-knowledge representation is in lieu of a warranty of “ownership” or of “full authority to grant the License.” Both of the quoted terms are ambiguous. In any event, if Licensor knows that it does not “own” the Licensed Software or have “full authority” to license it, that should preclude a no-knowledge representation of this kind. Note that “Knowledge

Representation” is defined in Section 1001.56 as including a duty to disclose any facts known to be necessary to make the representation not misleading.

Licensor’s counsel may actually prefer to give a warranty: as discussed in the comment to Section 701.3, in some jurisdictions a limitation of remedies for alleged misrepresentation might be subject to challenge.

A no-knowledge representation may seem at first glance to be favorable treatment of LICENSORS. It is often impossible, however, for LICENSORS to know with any certainty that some portion of the licensed software was not developed by an employee while working for a former employer, as in the *Plains Cotton v. Goodpasture case*, 807 F.2d 1256, 1262-64 (5th Cir. 1987), *cert. denied*, 108 S. Ct. 80 (1988). Similarly, in the unreported *Computer Associates v. Goal Systems* case of July, 1990, according to trade-journal accounts an employee of the defendant had included in the defendant’s software some routines that he had written while formerly employed by the plaintiff; reportedly the case settled quickly after the plaintiff executed an ex parte seizure of the defendant’s software under the Copyright Rules. *See also Computer Associates International, Inc., v. Altai, Inc.*, 775 F. Supp. 544, 553-54 (E.D.N.Y. 1991) (allegedly infringing source code in defendant’s software traced its origins to copy of plaintiff’s source code in possession of employee of defendant who was former employee of plaintiff).

Nor can a LICENSOR readily know whether some third-party patent might dominate the licensed software - a U.S. patent can issue years after the filing of the underlying patent application (and the application is kept secret until issuance), meaning that a dominating patent application could be pending without the LICENSOR’s knowledge.

Another possible approach might be for Licensor to give an outright non-infringement warranty, but to have the warranty limited to infringement of copyrights, trade secrets, and issued U.S. patents. At least these matters are something that a LICENSOR can attempt to investigate.

### **Committee Commentary**

Ordinarily, the grant of the license, including a patent license, is accompanied by an implied warranty that the LICENSOR has the legal authority to grant the license. However, generally, there is no implied warranty by the LICENSOR that the licensed technology does not infringe any Intellectual Property Rights owned by third parties.

When the license permits the LICENSEE to do almost anything it wants to do to fully exploit the licensed technology, Licensor may wish to insert language such as follows:

Nothing in this Agreement shall be construed as a warranty or representation that anything made, used, sold or otherwise disposed of under any license granted in this Agreement is or will be free from an infringement of Intellectual Property Rights of third parties.

The Licensor alternatively may wish to make a broader negation of any implications arising under the Agreement by use of the following clause:

Licensor makes no representations; extends no warranties of any kind, either express or implied; and assumes no responsibilities whatever with respect to use, sale or other disposition by Licensee or its Vendees or other transferees of products incorporating or made by use of a (a) inventions licensed under this Agreement or (b) information, if any, furnished under the Agreement.

A simple example of a “dominating patent” is a patent which covers a chair having three legs may cover a chair having four legs.

Also, unless “Affiliate of Licensee” is defined in the Agreement, this should be deleted as it may indicate that other parties could have rights under the Agreement.

2. 701.2 No Representation re Combination Use. LICENSOR makes no representation concerning any knowledge or lack thereof which it has or may have with respect to the possibility of such infringement by Combination Use of the Licensed Software. The Parties agree that LICENSOR has no duty to investigate nor to warn LICENSEE of any such possibility of infringement by Combination Use. As used in this Agreement, “Combination Use” of software means Use of the software in combination or conjunction with any of the following, unless such Use is shown to be infringing when not in combination or conjunction with any of the following, or unless such use is expressly described in the user documentation or expressly identified as non-infringing in this Agreement:

- (a) Any software other the software in question;
- (b) Any apparatus; and/or
- (c) Any non-Use activities by any Person.

### **ABA Commentary**

Section 701.2 excludes from the non-infringement knowledge representation any Combination Use of the Licensed Software with any other software or hardware except as set forth in the Documentation. Conceivably, capabilities or functions in Licensed Software that are not themselves infringing could be used by LICENSEE as a component in an infringing system or to control an infringing process. Such use is not covered by the non-infringement knowledge representation, nor by the defense obligation of Section 702, except in circumstances that amount to inducement of infringement or contributory infringement by LICENSOR.

In some jurisdictions, (a) limitations on tort remedies might be of questionable enforceability, and (b) an allegation of misrepresentation, especially an allegation of intentional misrepresentation, might be held to sound in tort and not in contract or warranty, meaning (c) the enforceability of this limitation of remedies for alleged misrepresentation might not be as clear-cut as a limitation of remedies for breach of warranty. Licensor counsel might therefore consider whether to style the non-infringement knowledge representation as a “to the best of Licensor’s knowledge” warranty (question: is that technically a warranty at all?), subject to the exclusive remedies set out herein.

### **Committee Commentary**

See Committee Commentary under 701.1.

3. 701.3 Exclusive Remedy re Infringement. LICENSEE’s **SOLE REMEDY** with respect to allegations or proof of infringement of third-party Intellectual Property Rights by the Licensed Software and/or its use by LICENSEE, regardless of any

alleged negligent misrepresentation by LICENSOR in making the Non-infringement Knowledge Representation, **TO THE EXCLUSION OF ALL OTHER REMEDIES THEREFOR**, will be for LICENSEE to invoke the infringement defense provisions of Section 702.

**ABA Commentary**

None.

**Committee Commentary**

None.

**B. 702. Defense Of Infringement Claims By Third Parties**

1. 702.1 Limited Covenant to Defend. As a covenant separate from the non-infringement Knowledge Representation, LICENSOR, at its own expense and subject to the terms and conditions of this Section 702, will defend Claims brought against LICENSEE in the United States by third parties (other than Affiliates of LICENSEE) that any of the following activities by LICENSEE constitutes infringement of an Intellectual Property Right under the laws of the United States or any of its states:

(a) Any making or distribution of copies of the Licensed Software that is expressly permitted by this Agreement (but not the creation of derivative works except as may be expressly agreed otherwise in writing by LICENSOR), **EXCEPT FOR** the making and/or distribution of copies of any alteration or modification of the Licensed Software created by any Person other than LICENSOR;

(b) Use of the Licensed Software (unaltered and unmodified by any Person other than LICENSOR) in accordance with the Licensed Documentation for a purpose (or to achieve an effect) that is described in the Licensed Documentation and consistent with the terms and conditions of this Agreement, **OTHER THAN** Combination Use (see Section 701.2) of the Licensed Software.

### **ABA Commentary**

Section 702.1 sets out Licensor's infringement-defense covenant. The underlying theory is that in many license arrangements, the LICENSOR will have considerably more of its business at risk than a LICENSEE if a third-party infringement claim arises. Furthermore, many LICENSEEs will take the position in negotiations that they are paying for the right to use the Licensed Software free of third-party interference (similar to a covenant of quiet enjoyment in a real estate lease). On the other hand, few Licensors can afford to bear *all* economic risks of third-party infringement claims. Consequently, these Model Provisions set out a defense obligation, but one that is limited in the amount of risk that the Licensor must bear.

The infringement-defense covenant is limited. For example, when a LICENSEE creates derivative works based on licensed software pursuant to a license agreement, the LICENSOR may well have absolutely no control over the nature of the derivative work and thus over whether it does or does not infringe any third-party rights. Accordingly, derivative-work creation is excluded here from the LICENSOR's defense obligation.

Because Licensee may have significant business interests riding on the Licensed Software, Licensor does not have the right to settle the case unilaterally by directing LICENSEE

to cease using certain infringing functions of the software, as LICENSOR does after a final judgment, below. Absent LICENSEE consent, LICENSOR's obligation is to defend the software to final judgment if a non-adverse settlement is not available. After a final adverse judgment, however, LICENSEE can invoke the Backup Remedy, but otherwise the risk of loss is on LICENSEE.

### **Committee Commentary**

Some members of the Committee felt that this section was biased toward the Licensee. For example, instead of the use of the word "defend" in 702.1, the Licensor may want the option or right to defend, settle or merely refund any license fee.

Also, instead of any "Intellectual Property Rights" this may be limited to copyright and, perhaps, trade secret infringement but not patent infringement.

Note this provision does not address suits filed outside the United States even though the license granted may extend outside of the United States.

The LICENSOR may agree to defend or hold harmless not only the LICENSEE, as here, but also LICENSEE's customers. Also, LICENSOR's obligations may extend to all subject matter within the scope of the licensed Intellectual Property Rights, unlike the language set forth in this section.

2. 702.2 Conditions for LICENSOR Defense. To be entitled to Defense by LICENSOR against a third-party infringement Claim:

(a) LICENSEE shall advise LICENSOR of the existence of the Claim, by the most expeditious reasonable means, immediately upon learning of the assertion of the Claim against LICENSEE (whether or not litigation or other proceeding has been filed or served); and

(b) LICENSEE shall permit LICENSOR to have the sole right to control the Defense and/or settlement of all such Claims, in litigation or otherwise, so long as no such settlement adversely affects LICENSEE's ability to exercise the License Rights without LICENSEE's prior consent. (See also Section 1002 concerning a Protected Party's right to monitor the defense.)

#### **ABA Commentary**

None.

#### **Committee Commentary**

Again, many Committee members felt that this clause favored the Licensee. At the end of (b) the following phrase should be added: "except as provided under Section 711.6 if invoked by LICENSEE."

In many cases, the obligation to defend infringement suits is retained by the LICENSEE. When this obligation is assumed by the LICENSOR, the obligation to defend is oftentimes based on the prompt informing of the LICENSOR in writing of any claim, the LICENSOR assuming exclusive control of the defense of any claim, as well as all negotiations, and the LICENSEE assisting the LICENSOR in the suit as follows:

The obligations of LICENSOR stated in paragraph 1, above, apply only if (a) LICENSEE shall promptly inform LICENSOR in writing of any claim within the scope of paragraph 1, (b)

LICENSOR is given exclusive control of the defense of such claim and all negotiations relating to this settlement, and (c) LICENSEE assists LICENSOR in all necessary respects in conduct of the suit.

A LICENSOR is not obligated to reimburse the LICENSEE for sums paid by the LICENSEE voluntarily and without consulting the LICENSOR to settle such an infringement suit. Furthermore, the LICENSOR is not liable for the fees and expenses of additional counsel retained by the LICENSEE.

3. 702.3 Infringement Injunctions Obtained by Third Parties. If a third-party infringement Claim, of which LICENSOR was notified in accordance with this Section 702, is sustained in a final judgment from which no further appeal is taken or possible, and such final judgment includes an injunction prohibiting LICENSEE from continued Use of the Licensed Software or portions thereof, then LICENSOR shall, in its sole election and at its expense:

- (a) Procure for LICENSEE the right to continue to use the Licensed Software pursuant to this Agreement; or
- (b) Replace or modify the Licensed Software to make it non-infringing; or
- (c) Direct LICENSEE to cease use of the Licensed Software or of the specific function(s) of the Licensed Software that resulted in the final judgment.

**ABA Commentary**

None.

### **Committee Commentary**

None.

4. 702.4 Licensee Option to Invoke Backup Remedy. If LICENSOR directs LICENSEE to cease use of the Licensed Software or of specific function(s) of the Licensed Software pursuant to Section 702.3(c), then LICENSEE will have the option to terminate the License pursuant to Section 902 and to invoke the Backup remedy set forth in Section 607.

{OPTION - DELETE IF INAPPLICABLE}

5. 702.5 Licensor Responsibility for Infringement Monetary Awards. If a third-party infringement Claim, of which LICENSOR was notified in accordance with this Section 702, is sustained in a final judgment from which no further appeal is taken or possible, then LICENSOR will pay or otherwise satisfy any monetary award entered against LICENSEE as part of such final judgment to the extent that such award is adjudged in such final judgment to arise from such infringement.

### **ABA Commentary**

An optional provision, Section 702.5, requires Licensor to be responsible for infringement damage awards against Licensee. This is very often a significant point of negotiation. Many agreements provide that Licensor's responsibility does not extend that far.

### **Committee Commentary**

This clause again seems to favor the Licensee over the Licensor. The LICENSOR's liability is oftentimes limited to a specific amount or the amount of compensation paid by the LICENSEE under the Agreement as follows:

LICENSOR's total liability to incur out-of-pocket costs in the defense of any suit or suits and to pay damages awarded in any suit or suits shall be limited to the amount theretofore paid to LICENSOR by LICENSEE under this Agreement, and LICENSEE will advance to LICENSOR any amounts required to be expended by LICENSOR in excess of that limit. Amounts so advanced shall be credited to future payments due from LICENSEE to LICENSOR as a result of LICENSEE's operations under this Agreement.

The foregoing paragraphs of this Article state the entire liability of LICENSOR to LICENSEE in respect to LICENSEE's use of Licensed Software, and except as specifically provided in those paragraphs, LICENSOR shall not be liable either directly or as an indemnitor of LICENSEE because of any claim arising in any way from LICENSEE's use of Licensed Software.

If the obligation to defend is retained by the LICENSEE, the Agreement may provide that funds expended by the LICENSEE will be deducted from any royalties that the LICENSEE is to pay LICENSOR. Alternatively, the Agreement may provide that in the event of suit against LICENSEE, the LICENSEE will have the right to withhold payment of royalties, or pay royalties into escrow, during pendency of the suit and upon conclusion of the suit, funds expended by the LICENSEE will be deducted from the withheld royalties.

If the parties agree to share costs and expenses of any such suit, the Agreement should establish which party has the primary authority and responsibility for the defense and possible settlement of the suit in Section 702.2.

If the LICENSEE is required to pay royalties to a third party in settlement of an infringement suit, royalties payable to the LICENSOR may be correspondingly reduced.

Many members of the Committee felt that only in special situations should a Licensor undertake to indemnify the Licensee against the possibility that activities performed under the license may infringe Intellectual Property Rights of third parties. This is because the Licensor would rarely be in a position to foresee the nature of the Licensee's future activities and thus to evaluate the magnitude of the risks in extending indemnity.

Indemnification by a Licensor is more common in agreements to transfer the right to use trade secrets and know-how which are incorporated in source code, documents and any related hardware actually delivered to the Licensee. For example, when circumstances known in advance tend to fix the Licensee's design and when payments likely to be made by the Licensee are large, it may seem reasonable, especially to the Licensee, that the risks of indemnification be assumed by the Licensor.

In such a case, the Licensee may insist upon the following pro-Licensee provision:

**Indemnifications By Licensor:**

1. LICENSOR will assume the defense of any suit brought against LICENSEE or its vendees, mediate or immediate, for infringement of any Intellectual Property Rights or for wrongful use of Proprietary Information of any third party insofar as such suit is based on a claim that the infringement or wrongful use is attributable to LICENSEE's application without substantial modification of Licensed Software supplied under this Agreement. In any such suit, LICENSOR will indemnify LICENSEE against any money damages or costs awarded in such suit in respect to such a claim.

If the LICENSOR fails to protect the LICENSEE in accordance with this provision, the LICENSOR is typically precluded from recovering royalties, the LICENSEE may cancel the Agreement and the LICENSOR may be liable for damages.

**C. 703. Confidential/Proprietary Information**

This Section sets out procedures by which information regarded as proprietary by a Party (referred to in this Section as “Proprietor”) may be disclosed to another Party (referred to in this Section as “Receiving Party”).

{OPTION}

1. 703.1 Licensed Software as Confidential/Proprietary Information. The Parties acknowledge that the Licensed Program(s) and Licensed Documentation will be deemed Confidential/Proprietary Information (as defined below) whose use and disclosure is restricted by this Section 703.

**ABA Commentary**

These Model Provisions use the term “Confidential/Proprietary Information” instead of the more traditional “Confidential Information.” An experienced practitioner who reviewed Working Draft 2.0 commented that the Department of Defense is likely to object to the use of the traditional term in its license agreements because the designation “Confidential” is reserved for specific categories of classified information; on the other hand, the term “Proprietary Information” may not translate well into some non-English languages.

Accordingly, at the suggestion of that practitioner, these Model Provisions use a hybrid of the two terms.

Optional Section 703.1 states that the Licensed Software is Confidential/Proprietary Information. Whether the term “trade secret” can encompass executable code that is distributed through mass-market channels, e.g., over the counter or by mail order with a so-called “shrinkwrap license” is not settled. Design documentation of computer programs will almost certainly be maintained as trade secrets. Bear in mind, however, that seldom if ever will the user documentation of mass-marketed computer programs be likely to qualify as trade secrets.

### **Committee Commentary**

The Michigan Supreme Court spoke on the subject of trade secrets in *Hayes-Albion Corp. v. Kuberski*, 421 Mich. 170, 364 N.W.2d 609 (1984). This case was the first occasion that plaintiff had prevailed in a trade secret suit before the Michigan Supreme Court since 1927. Among the case highlights, the Supreme Court for the first time expressly adopted the definition of trade secrets found in the Restatement of Torts § 757 Comment B. The Court also distinguished hard information such as industrial processes which are protectable by injunction and soft information such as customer requirements with respect to which relief is limited to money damages.

The “Uniform Trade Secrets Act”, enacted by the State of Michigan on December 30, 1998 at PA 448 supplements the prior case law and defines “trade secret” broadly. The definition, for example, is broad enough to cover research results and specifically covers

“programs.” The Restatement of Torts § 757 Comment B (1979) ordinarily defines trade secret to, for example, exclude research results.

{OPTION}

2. 703.2 No Proprietary Disclosures by Licensee. The Parties do not intend that LICENSEE will disclose to LICENSOR, and agree that LICENSEE will refrain from disclosing to LICENSOR, any information that LICENSEE regards as proprietary. LICENSEE warrants that all information disclosed to LICENSOR by LICENSEE is or will be free of any obligation of confidence.

{COMMENT: The balance of this Section 703 is a more-or-less standard confidentiality provision.}

#### **ABA Commentary**

Optional Section 703.2 disavows any obligation of confidence on the part of Licensor with respect to Licensee information. Obviously, this provision will be inappropriate in many license deals, e.g., where the LICENSOR will be developing or customizing a system specific to the LICENSEE’s needs - the LICENSOR may have access to a great detail of proprietary business information of the LICENSEE.

#### **Committee Commentary**

None.

3. 703.3 Definition of Confidential/Proprietary Information. As used herein, the term “Confidential/Proprietary Information” means information that:

(a) is disclosed in writing or other tangible form to the Receiving Party by the Proprietor or a Person having an obligation of confidence to the Proprietor (or, if disclosure is made orally, is reduced to or summarized in such a writing or other tangible form within thirty days after such oral disclosure) and is designated in such writing or tangible form as proprietary in a writing by or on behalf a Proprietor,

(b) is not generally known in the relevant industry or industry segment, and

(c) affords possessors of the information a commercial or business advantage over others who do not have the information.

#### **ABA Commentary**

Not all information will necessarily be Confidential/Proprietary Information. Section 703.3(a) requires that such information be designated in writing. In an arms-length business relationship of comparatively narrow scope, it is generally undesirable to treat *all* business information indiscriminately as “proprietary.” This may be true for no other reason than such treatment can dilute the credibility of trade-secrecy assertions made about information that is truly proprietary. Accordingly, the parties may well desire to provide that, if information is to be treated as proprietary, it must be so designated in writing. In a broader or closer working relationship, however, it may well be preferable to omit the written-designation requirement, meaning that even oral disclosure of Proprietary Information will be subject to a confidentiality obligation.

The remainder of Section 703.3 is adapted from Section 757 of the Restatement of Torts, which includes a definition of “trade secret” that has been widely adopted by the courts of various states.

### **Committee Commentary**

"Proprietary Information" has also been defined to mean the content of Technical Information furnished by one party that has been originated by or is particularly within the knowledge of that party and is subject to protection under recognized legal principles.

The phrase “Proprietary Information” has been criticized as a "question-begging" term used to describe any information in which courts will recognize at least some exclusive rights.

4. 703.4 Illustrative Types of Confidential/Proprietary Information. Subject to the requirements of this Section 703, the term “Confidential/Proprietary Information” may include, by way of illustration but without limitation except as expressly set forth herein (the following enumeration of examples shall not be construed, in itself, to grant a Receiving Party by implication any rights with respect to any particular item of Confidential/Proprietary Information):

(a) any and all information relating to products manufactured by a Proprietor, processes therefor, apparatus and maintenance thereof, research, research programs, computer software, manufacturing techniques, processes, program files, developments for experimental work, flow charts, drawings, techniques, source and executable codes, standards, specifications,

improvements, inventions, customer information, accounting data, statistical data, research projects, development and marketing plans, strategies, forecasts, customer lists, sales plans and sales and marketing information, and the like, that is/are in the possession of or may be acquired by or on behalf of the Proprietor, including similar information with respect to any subsidiary or related companies of the Proprietor;

(b) the fact of a Proprietor's selection and use of particular information in connection with this Agreement and its subject matter, whether or not the particular information is publicly available;

{OPTION}

(c) the terms of this Agreement and the fact of a Party's entry into this Agreement.

#### **ABA Commentary**

Section 703.4 sets out a standard catch-all list of examples of potential Proprietary Information.

#### **Committee Commentary**

None.

5. 703.5 Exclusions from Proprietary-Information Status. The term "Confidential/Proprietary Information" does not include any information that, through no fault of the Receiving Party, is or becomes:

(a) described in an issued or published U.S. or non-U.S. patent; or

(b) described in a printed publication distributed to more than 100 Persons in the U.S. or Canada; or

(c) developed independently by or on behalf of the Receiving Party as shown by documentary evidence; or

(d) disclosed to the Receiving Party by a third Party not having an obligation of confidence to the Proprietor of the information as shown by documentary evidence. No combination of information will be deemed to be within any of the foregoing exceptions, however, regardless whether the component parts of the combination are within one or more exceptions, unless the combination itself and its economic value and principles of operation are themselves so excepted.

#### **ABA Commentary**

Section 703.5 excludes certain categories of information from the definition of Confidential/Proprietary Information. It avoids the term “public domain,” which is sometimes used in confidentiality clauses as a shorthand expression of what information will not be treated as confidential, because that term is imprecise and potentially inaccurate. Information may be in the public domain in the sense that it is unprotected by patents, but the fact of its value in particular circumstances may be a legitimate trade secret of the Proprietor. Furthermore, secrecy is relative and absolute secrecy is not a prerequisite to trade-secret protection; there is no generally accepted meaning for “public domain” with respect to the confidential or trade-secret status of information.

Subparagraph (b) of Section 703.5 excludes information contained in a “printed publication” from confidential status. In some license agreements, the parties may wish to spell out carefully what they mean by a “printed publication.”

### **Committee Commentary**

Alternatively, the following language may be used:

The non-disclosure obligations of the Receiving Party under this Agreement do not apply to Confidential/Proprietary Information which:

- a) at the time of the disclosure is generally available to the public or thereafter becomes generally available to the public through no act or omission of the Receiving Party or its employees; or
- b) the Receiving Party can show by written records to have been in Receiving Party's possession prior to the time of the disclosure and was not acquired, directly or indirectly, from the Proprietor; or
- c) the Receiving Party can show by written records to have been independently made available as a matter of right to the Receiving Party by others, provided such others did not acquire the Confidential/Proprietary Information directly or indirectly from the Proprietor; or
- d) is required to be disclosed by law or court order.

6. 703.6 Security Conditions. Confidential/Proprietary Information will be maintained under secure conditions by a Receiving Party, using reasonable security measures and in any event (a) not less than the same security procedures used by the Receiving Party for the protection of its own Confidential/Proprietary Information of a similar kind, and (b) any specific security measures required by this Agreement.

### **ABA Commentary**

Section 703.6 requires the Receiving Party to take reasonable security precautions to protect the Proprietor's Confidential/Proprietary Information, and in any case to treat the information as carefully as the Receiving Party's own Proprietary Information. Some companies have detailed lists of stringent security precautions that they wish to impose in disclosing certain categories of Proprietary Information to outsiders. Such a list can be conveniently attached as a schedule.

### **Committee Commentary**

Suggested language here may be as follows: "The Receiving Party will use reasonable efforts to keep such Proprietary Information confidential and shall not be liable for unauthorized disclosures of such information by its employees."

However, occasionally, the parties will provide that the Receiving Party will indemnify the Proprietor for any breach of confidence.

The Proprietor can gain additional protection by requiring the Receiving Party to cause all of its key employees to agree in writing to be bound individually by the restrictions concerning confidential/proprietary information imposed on the Receiving Party.

7. 703.7 Non-Use Obligation. The Receiving Party shall not use any Confidential/Proprietary Information, except for the benefit of the Proprietor, without the express prior written consent of an authorized officer of the Proprietor, for a period ending three (3) years after the later of:

- (a) the date of termination of the Receiving Party's right to possess and/or use Confidential/Proprietary Information (e.g., termination or expiration of the license), and
- (b) the date of the Receiving Party's actual cessation of such possession and/or use.

### **ABA Commentary**

Section 703.7 sets out a non-use obligation that ends three years after the latest of various events. The three-year period is akin to a statute-of-limitations or-repose period. A Receiving Party's personnel may well remember general concepts and the like, learned through their exposure to Confidential/Proprietary Information, long after the tangible embodiments of Confidential/Proprietary Information have been returned to the Proprietor. They may legitimately not be able to separate Confidential/Proprietary Information from non-Proprietary Information in their minds, however. This clause cuts off disputes about the propriety of using such remembered information after three years. Note that there is no statute of repose for the non-disclosure obligation as there is for the non-use obligation.

### **Committee Commentary**

Ordinarily, there is nothing inherently confidential in the relationship between a LICENSOR and LICENSEE if the license is merely a patent license with no software being transferred. However, if any software is given to the LICENSEE, whether in source or object form, the terms governing its restricted use by the LICENSEE must be expressly incorporated in the Agreement.

Also, depending on the granting clause, it may be desirable to add the following language at the beginning of the opening sentence: “Except as authorized by this Agreement,”.

8. 703.8 Non-Disclosure Obligation.

(a) Except as may be otherwise permitted by this Agreement, no Receiving Party shall disclose any Confidential/Proprietary Information to any third party without the prior consent of the Proprietor.

(b) A Receiving Party may disclose appropriate portions of Confidential/Proprietary Information to those of its Personnel who have a substantial need to know the specific information in question in connection with the Receiving Party’s exercise of rights or performance of obligations under this Agreement. All such Personnel will be instructed by the Receiving Party that the Confidential/Proprietary Information is subject to the obligation of confidence set forth by this License Agreement.

**ABA Commentary**

None.

**Committee Commentary**

None.

9. 703.9 No Unauthorized Copying. Except as may be otherwise permitted by this Agreement, the Receiving Party shall not copy, duplicate, reverse engineer, reverse

compile, disassemble, record, or otherwise reproduce any part of Confidential/Proprietary Information, nor attempt to do any of the foregoing, without the prior written consent of the Proprietor. Any tangible embodiments of Confidential/Proprietary Information that may be generated by a Receiving Party, either pursuant to or in violation of this Agreement, will be deemed to the sole property of the Proprietor and fully subject to the obligation of confidence set forth in this Section.

**ABA Commentary**

None.

**Committee Commentary**

None.

10. 703.10 Disclosure Ordered by Governmental Bodies. If a Receiving Party is ordered by a court, administrative agency, or other governmental body of competent jurisdiction to disclose Confidential/Proprietary Information, or if it is served with or otherwise becomes aware of a motion or similar request that such an order be issued, then the Receiving Party will not be liable to the Proprietor for disclosure of Confidential/Proprietary Information required by such order if the Receiving Party complies with the following requirements:

(a) if an already-issued order calls for immediate disclosure, then the Receiving Party shall immediately move for or otherwise request a stay of such order to permit the Proprietor to respond as set forth in this subparagraph;

(b) the Receiving Party shall immediately notify the Proprietor of the motion or order by the most expeditious possible means; and

(c) the Receiving Party shall join or agree to (or at a minimum shall not oppose) a motion or similar request by the Proprietor for an order protecting the confidentiality of the Confidential/Proprietary Information, including joining or agreeing to (or non-opposition to) a motion for leave to intervene by the Proprietor.

**ABA Commentary**

None.

**Committee Commentary**

This language may be deemed overbearing in favor of the Licensor.

11. 703.11 No Removal of Proprietary Legends. No Receiving Party shall remove, obscure, or deface any proprietary legend relating to the Proprietor's rights, on or from any tangible embodiment of any Confidential/Proprietary Information, without the Proprietor's prior written consent.

**ABA Commentary**

None.

**Committee Commentary**

Notice may be given to the public that Licensed Goods are patented by marking the goods in a manner prescribed by the Patent Statute, 35 U.S.C. § 287.

Failure of a LICENSEE (and/or a Sublicensee if contemplated by the Agreement) to mark on Licensed Goods the number(s) of applicable patents under the Agreement may, under the patent statutes, prevent the LICENSOR (or the LICENSEE, if it has the right to sue) from collecting damages for past infringement (i.e., infringement occurring prior to actual notice to the infringer of the infringement) in a suit brought against a third party on such patents.

However, if the LICENSEE marks the Licensed Goods with the number of the licensed patent, the LICENSEE may be estopped from arguing that the goods do not infringe the licensed patent. A simple license provision may be as follows:

LICENSEE agrees to mark all Licensed Products sold or otherwise disposed of by and under the license granted in this Agreement with the word "Patent" and the number of the Licensed Patent.

A patent LICENSOR who is transferring rights under process patents likely to be litigated should review 35 U.S.C. § 287(b)(1)-(6) enacted in 1988. Section 287(b)(4)(B) which applies to process patent marking and notice issues, provides an option to a LICENSEE who receives a request for disclosure for the identity of any process patent being used. These additions to Section 287 under the Process Patents Improvement Act of 1988 suggest that the LICENSOR may desire the following language be included in the marking provision of any license transferring rights under process patents that have a likelihood of being litigated:

LICENSEE agrees to mark any products made using a process covered by any Licensed Patent with the number of each such patent and, with respect to Licensed Patents, to respond to any request for disclosure under 35 U.S.C. § 287(b)(4)(B) by notifying LICENSOR of the request for disclosure.

12. 703.12 Reports of Third-Party Misappropriation. A Receiving Party shall immediately report to the Proprietor any attempt by any Person of which the Receiving Party has knowledge (a) to use or disclose Confidential/Proprietary Information without authorization from the Proprietor, or (b) to copy, reverse assemble, reverse compile or otherwise reverse engineer any part of the Licensed Software.

**ABA Commentary**

Section 703.12 requires a Receiving Party to notify the Proprietor of third-party misappropriations of Confidential/Proprietary Information. See also Section s711, which sets out procedures for taking action against third-party infringers.

**Committee Commentary**

None.

13. 703.13 Post-Termination Procedures. Upon any termination of the Receiving Party's right to possess and/or use Confidential/Proprietary Information (e.g., termination or expiration of the license), the Receiving Party shall turn over to the Proprietor (or, if agreed by the Proprietor, destroy) any disks, tapes, Documentation, drawings, blueprints, notes, memoranda, specifications, devices, documents, or any other tangible embodiments of any Confidential/Proprietary Information.

**ABA Commentary**

None.

### **Committee Commentary**

The parties often provide that the obligation of secrecy survives termination of the Agreement and all information in tangible form relating to the Licensed Programs is to be turned over to the LICENSOR. This is because ordinarily the rights and obligations of the parties come to an end upon expiration of the Agreement.

#### **D. s711. INFRINGEMENT BY THIRD PARTIES**

s711.1 LICENSOR will be in charge of all litigation against and settlement with any and all third party infringers of LICENSOR's Intellectual Property Rights, and LICENSEE will cooperate in any such action, in accordance with this Section s711.

s711.2 LICENSEE will promptly notify LICENSOR upon learning of any potential infringement by third parties of any of LICENSOR's Intellectual Property Rights.

s711.3 LICENSEE will cooperate with LICENSOR as requested by LICENSOR, at LICENSOR'S expense in accordance with this Section, in connection with any action taken by LICENSOR in its judgment against such potential infringer(s).

(a) Such cooperation by LICENSEE will include without limitation providing its personnel to appear as witnesses at depositions or in court, furnishing documents and information, executing all necessary documents, and being joined as a party to any legal proceedings.

(b) The cost of any litigation or other action against potential infringers will be borne entirely by LICENSOR. LICENSOR will reimburse LICENSEE, within thirty days after request from LICENSEE, for any Travel Expenses, photocopying expenses, and the like (but excluding salary or comparable expenses as well as fees and expenses charged by separate counsel, if any, engaged by LICENSEE) incurred by it at LICENSOR's request in connection with any such infringement action.

s711.4 Any recovery of damages or attorney's fees in such actions, or in settlement of such actions or disputes, will belong entirely to LICENSOR.

s711.5 LICENSOR will have no obligation to LICENSEE to institute suit against any particular infringer.

{OPTION}

s711.6 If LICENSOR declines to bring or continue suit against an infringer, LICENSEE may at its option and expense assume the prosecution of the suit, in which case all provisions of this Section s711 referring to LICENSOR will be deemed to refer to LICENSEE and vice versa, mutatis mutandis.

#### **ABA Commentary**

This section provides that any recovery of damages or attorney's fees in such actions, or in settlement of such actions or disputes, will belong entirely to LICENSOR. Another possible allocation of recoveries might be, say, two-thirds to LICENSOR and one-third to LICENSEE after first deducting all costs and expenses associated with the action or dispute.

Optional Section s711.6 permits Licensee to sue infringers if Licensor declines to do so. Note, however, that normally only an exclusive LICENSEE can be given the power to bring a suit for infringement against third parties.

### **Committee Commentary**

When the license involved is a mere non-exclusive license, the LICENSEE does not have the right to bring, in federal court, in its own name an infringement suit seeking equitable remedies unless the owner participates.

The LICENSOR retains sole right to bring a patent suit unless: 1) the LICENSOR transfers an undivided share of an exclusive right under a patent throughout the United States; 2) the LICENSOR grants a limited exclusive license (such as a field of use license); or 3) the LICENSOR grants something more than a non-exclusive license but less than an assignment. In these situations, both parties are indispensable to a lawsuit against infringers.

When the license falls within one of the above situations, the LICENSEE may be empowered by the LICENSOR to bring suit by means of the following sample provisions:

LICENSEE is empowered to bring suit in its own name or, if required by law, jointly with LICENSOR at its own expense.

Such a license provision may also include the following:

In the event that LICENSOR shall bring to the attention of LICENSEE any unlicensed infringement of the Licensed Patents and LICENSEE shall not within six months:

- a. secure cessation of the infringement,
- b. enter suit against the infringer, or
- c. provide LICENSOR with evidence of the pendency of a bonafide negotiation for the acceptance by the infringer of a sublicense under the licensed patents,

The license herein granted to LICENSEE shall forthwith become non-exclusive and the LICENSOR shall thereafter have the right to sue for the infringement at LICENSOR's own expense.

Sometimes the LICENSEE is required to share recoveries with the LICENSOR, and is restricted in regard to the terms on which any infringement suit can be settled.

Also, the LICENSOR is typically expressly obligated to cooperate with the LICENSEE in the suit. Failure to cooperate precludes the LICENSOR from recovering royalties accruing thereafter.

A LICENSOR generally has no obligation to protect the non-exclusive LICENSEE from competitive harm caused by an infringement of a Licensed Patent. The LICENSEE therefore may wish to negotiate contractual protection either by imposing on the LICENSOR an obligation to eliminate such infringement or by obtaining the right to sue infringers on behalf of the LICENSOR as noted above. Failure of a LICENSOR in such a situation then may relieve the LICENSEE of its obligation to pay royalties.

Where the LICENSEE sells products embodying or made using the licensed technology, a threshold level of infringing sales in direct competition with the LICENSEE should serve as a condition precedent to the LICENSOR's obligation to bring suit. The LICENSOR therefore would not be obliged to pursue every infringer, but only meaningful infringers.

Another condition precedent in such a licensing provision is to limit the LICENSOR's obligation to one infringement suit at a time. Other provisions may impose the burden of abating infringement on the LICENSOR and provide for the abatement of royalties until the LICENSOR complies with the provision.

The obligation to sue for infringement could be optional, leaving the LICENSEE with the right to sue if the LICENSOR fails to do so. The LICENSEE's right to sue may be in conjunction with or in lieu of the abatement of royalties.

Unless the Agreement includes a transfer of claims for past infringement, the LICENSEE in the above example may only recover damages for infringement occurring subsequent to the date of the Agreement.

Still another approach is to have the parties participate jointly in suits against infringers. In this case, the parties usually share expenses and recoveries in accordance with a predetermined formula. Such an Agreement should prescribe which party has a right to select counsel and to control prosecution of the suits.

With specific reference to Section 711.3(b), an optional clause could be used to include reimbursement of salaries and benefits.

With specific reference to Section 711.6, after “all provisions of his Section 711” insert “and Section 702.”

### **III. CONCLUSION**

Many of the Model Provisions of Article 7 were viewed by the Committee as being more favorable to the Licensee than the Licensor. The Committee has suggested many alternative provisions for these and other Model Provisions. As recommended in the 1998 report of the Committee, boiler plate and model provisions and clauses cannot be taken on their face, but rather provide a starting point for initial study and then drafting.

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Kathy 7/16/99