

GETTING THE INFORMATION TECHNOLOGY AGREEMENT DONE IN THE AGE OF *KILLER*

Sellers of goods or services involving intellectual property should be liable to buyers if the stuff they sell infringes upon the intellectual property rights of third parties, right?

Yes. Most of the time, anyway.

By Gail H. Bacon and Stephen L. Tupper

Allocating risks in a rapidly-changing technical landscape is not a new process. It happens whenever an industry experiences rapid growth and innovation or reaches the critical mass that makes it economically viable in the first place. It has happened often in parts of the automotive, energy, pharmaceutical, and other industries and it will happen again. But perhaps nowhere else have all of these factors come together more forcefully in a short time than in the information technology industry, and particularly in the realm of the Internet.

Add to this a 1998 Federal Circuit decision expressly allowing a long-repressed breed of patents that are particularly applicable to the information technology industry and you have a volatile and unpredictable legal landscape in which to contract. Buyers of information technology products and services come to the table with legitimate interests in acquiring non-infringing technology that they can use without fear of interference from third parties. Sellers of information technology products and services arrive at the same table with applications developed or procured in good faith, wanting to license their technology without also insuring the buyer against the obsolescence of the industry.

Both interests are legitimate and heartfelt. Where do you draw the line to reach agreement in an information technology deal?

Origins of Killer Patents

To call a patent a “killer patent” is perhaps melodramatic, but certain patents have caused substantial stirs in the community of

*nancial Group*¹ in 1998. A rival financial institution charged that patentholder State Street Bank & Trust Co.’s patent² was invalid because it fell into the so-called “business method exception” for which no patent protection was available.³ The Federal Circuit read Section 101 of the United States Patent Act⁴ literally and held that a business method could, indeed, constitute a “new and useful process, machine, manufacture, or composition of matter, or . . . new and useful improvement thereof,”⁵ entitling its inventor to a patent.

State Street opened the floodgates. As of late 2004, the United States Patent and Trademark Office (USPTO) classes and subclasses that cover much of the Internet and information technology fields contained 4,394 issued United States patents and the USPTO had published another 6,596 applications.⁶

The paradigm of business method patents on the Internet is the Amazon.com “one-click” patent,⁷ which covers the purchase of goods and services using a single mouse click. Still others deal with any number of other business and technological methods, as well as processes and systems to implement them.

Some critics of business method patents object to the broad scope of such patents and assert the obviousness and non-novelty of many issued patents. One patent that is the target of such criticism covers accumulation of product registration information until a network connection is detected and then uploading the product registration information.⁸ Another involves training janitorial personnel in office cleaning using posters.⁹ In late 2002, one patent holder

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those who buy and sell technology rights. We define this particular subspecies of patent as one with broad claims and a similarly broad class of potential infringers in a relatively young or fast-growing industry, such as information technology and the Internet. Such patents take the field by surprise and, depending on one’s view, announce and disclose new and valuable technology or chill the market by making the information superhighway into a toll road. Killer patents are generally one of two types.

Business Method Patents

The United States Court of Appeals for the Federal Circuit rendered its decision in *State Street Bank & Trust Co v Signature Fi-*

committed to the public domain its rights¹⁰ under an issued patent covering a reservation system for the use of restrooms.¹¹

But, for better or for worse, business method patents are here for at least the near future. Legislation aimed at major reform of the business method patent landscape failed to emerge from either the 107th or the recently-departed 108th Congress.

Assertion of Rights in Traditional Patents

Even traditional patents pose potential risks. In June of 2000, British Telecom began asserting that it owned the rights to the ubiquitous hyperlink,¹² that underlined colored text or the icon that, when clicked, calls up new or different information from

another source on the web and is, for all practical purposes, the heart and soul of the web.¹³ Far from a recent entry onto the intellectual property landscape, BT's claim was based on a patent issued in 1989.

Issues at the Negotiation Table

Most information technology agreements contain a warranty provision and an indemnification provision, either or both of which address potential infringement to one extent or another. The warranty binds the

licensor to certain statements about the goods or services and forms the basis of a breach of contract if the statements are not true. The indemnification provision describes circumstances under which the licensor must defend the licensee against allegations of, and/or damages and costs resulting from, infringement by the licensed goods or services of the rights of a third party. The emergence of a claim requiring indemnification is usually not itself a breach of the agreement, even if it imposes on the licensor obligations nearly as burdensome as in the case of a breach. Many forms of agreement do not contain a non-infringement warranty, relying instead on the indemnification provision for the licensee's protection.

The primary topic of conversation when it comes to intellectual property infringement is the nature and sensitivity of the triggers for the warranty and the indemnification obligation.

The Arguments

Both buyers and sellers of products and services in the information technology industry (to whom we will refer by the broad labels of licensees and licensors) have legitimate and well-founded arguments.

Licensees

The arguments of licensees take relatively few words to summarize. This is not to say that licensee arguments necessarily carry less weight. In fact, they have the benefit of conciseness and the ring of the moral high ground.

Licensees should receive clean intellectual property that they can use without worrying about third-party interference. The licensee should not have to buy a lawsuit. The licensor is usually in a better position to know about, and assess, the risk of infringement. The licensor also usually makes or renders the goods or services and is in a position to design and build around potentially infringing uses.

Licensors

Licensor arguments take more words to articulate, but they are no less valid.

It is difficult to identify third-party intellectual property rights or to be sure of freedom to operate in the information technology

Fast Facts:

Some critics of business method patents object to the broad scope of such patents and assert the obviousness and non-novelty of many issued patents.

It is difficult to identify third-party intellectual rights or be sure of freedom to operate in the information technology field.

The circumstances of the technology, the nature of the performances, the bargaining power of the parties, the persuasiveness of counsel, and many other factors all weigh into the final form of the information technology agreement.

field. The USPTO is required by law to keep patent applications in confidence for at least 18 months after the earliest filing date of which an applicant seeks the benefit.¹⁴ A patent holder's right to royalties could begin as early as the date upon which the USPTO publishes the application,¹⁵ provided that the patent issues. Thus, a licensor could develop software or a system for a licensee only to find, 18 months later, that the developed software or system infringes upon the claims in a patent application filed while the

licensor was writing code in good faith with no knowledge, or ability to obtain knowledge, of the potential infringement.

In addition, it is difficult for many licensors to efficiently review even the information that *is* available. Even experienced patent searchers have difficulty identifying relevant information about technology patents. Patent titles are often less than helpful. Claims are not necessarily that revealing, either. Add to this the fact that the fees of professional searchers are usually prohibitive, but technical or clerical (or, in any case, non-legal) personnel, though cheaper, are much more likely to miss important patents or applications.

Further, the allocation of risk to the licensee sounds reasonable on its face, but has unique consequences in the information technology sector. In almost no other context do buyers require sellers to insure against the obsolescence of their intended use of the product. If a consumer buys a General Motors vehicle, the consumer generally expects that the vehicle will have the promised features, run reasonably well, and otherwise conform to its warranty. But, if the highway upon which the consumer plans to use the vehicle becomes a toll road after the customer purchases the vehicle, no one would reasonably expect GM to pay the tolls.

Some activities involve inherent risk of infringement and that risk is an inextricable property of the activity, not a risk brought on by the licensor itself. A licensee that wishes to avail itself of the marketing and communication power of the Internet should assume some of that risk as a part of its decision to use that medium.

Secular Factors

Many factors that affect license agreements are dependent upon circumstances and do not favor licensors or licensees in particular. Agreements covering goods and services that are more generic, less value-added, in a mature technology sector, in a crowded vertical market, and for which there are many suppliers on a commodity basis, call for less sensitive triggers and smaller degrees of liability.

Agreements covering goods and services that are specific solutions, have more value added, are in a newer technology sector, are in a less crowded vertical market, and are specialized solutions of a type that only the licensor provides, call for more sensitive triggers and larger degrees of liability.

The respective positions of parties in areas other than technical knowledge also matter. It is not uncommon for a licensor or licensee to be small enough that a particular agreement provision translates to “betting the company” in an unknown information technology environment. In such a case, one party or the other may do well to wholly or partially concede on a warranty or indemnification provision in exchange for more favorable treatment on an unrelated term. Adding additional defaults and liability of the same nature do not increase protection when the other party would be rendered insolvent by liability already negotiated. The other party can bet the company only once, and overkill in intellectual property protection may mean foregoing other more valuable concessions.

What’s Reasonable?

The circumstances of the technology, the nature of the performances, the bargaining power of the parties, the persuasiveness of counsel, and many other factors all weigh into the final form of the information technology agreement.

All of that being equal:

- Liability should fall to a party to the extent that the party actually knows (or could, with reasonable diligence, know) of the actual or potential infringement. The difficulty or ease of obtaining such knowledge should weigh into the negotiation, perhaps even by specifying a universe of publications or other resources as a proxy for the party’s knowledge.
- Risks that are truly bound up in the medium or subject matter (such as risks that affect the entire Internet) are good candidates for sharing among the parties.
- Risks associated with combining technologies of the licensor and the licensee are also good candidates for sharing, especially where it is the combination itself that is most likely to infringe.
- A licensor should expect to take on more risk for higher-margin specialty work in a narrow field in which the licensor is expert or is specifying the form of the solution or design.
- A licensee should expect to take on more risk for commodity work that is priced thinly in densely-populated fields where the licensor’s expertise is not as important, and especially where the licensee specifies the design or substantial elements of it.

The Negotiation

The technical discussion is all well and good, but good lawyers are also good counselors. It is tempting to place responsibilities and risk allocation in the same way one might assign blame or culpability. In cases where a party actually does bad acts, this approach is both proper and satisfying. But negotiating information technology agreements well is about describing performances and allocating risks. Focus your energies on reaching the result that gives each party its reasonable expectation. Negotiations will occur more efficiently and resulting agreements will be more effective.

Conclusion

Killer patents affect the information technology and Internet markets in unique and powerful ways. The combination of rapid

technical development and the introduction and growth of business method patents make this one of the most interesting and unpredictable landscapes to confront contracting parties in decades. Agreements can and should allocate responsibility according to the real risks, the parties’ relative abilities to see and avoid problems, and the nature of the medium in which the parties operate. Knowing where the risks are and allocating them in realistic and principled ways makes the contracting process more efficient and presents a solid opportunity for lawyers to add value in their client relationships with technology buyers and sellers. ♦

The authors are indebted to Michelle R. Osinski of Dykema Gossett PLLC’s Intellectual Property Practice Group for her research efforts.

Gail H. Bacon is the chief contract administrator at Fry, Inc., a leading developer and host of World Wide Web applications and Internet commerce solutions. She recently completed the Legal Assisting program at Eastern Michigan University and will attend the University of Toledo College of Law beginning in the fall of 2005.

Stephen L. Tupper is an associate in Dykema Gossett PLLC’s Bloomfield Hills office, a member of the firm’s E-Commerce and Technology Law Team and Corporate and Finance Practice Group, and the secretary of the Computer Law Section of the State Bar of Michigan. He represents both licensees and licensors in a broad range of information technology transactions.

Footnotes

1. 149 F3d 1368 (Fed. Cir. 1998).
2. United States Patent no. 5,193,056 (Data Processing System for Hub and Spoke Financial Services Configuration) issued Mar. 9, 1993.
3. The USPTO maintains that it has allowed “automated financial/management business data processing method patents” since 1889. See USPTO White Paper: *Automated Financial or Management Data Processing Methods (Business Methods)* <http://www.uspto.gov/web/menu/busmethp/index.html> (visited February 1, 2005).
4. Title 35 of the United States Code.
5. 35 USC 101.
6. Survey conducted by the authors in November 2004 of United States patents and applications published on the USPTO’s website at www.uspto.gov using Class 705 and Subclasses 14, 17, 20, 26, 27, 39, 44, and 45 (Automated Electrical, Financial, or Business Practice or Management Arrangement) and Subclasses 64, 65, 66, 67, 75, 76, 77, 78, and 79 (Business Processes Using Cryptography).
7. United States Patent no. 5,960,411 (Method and System for Placing a Purchase Order via a Communications Network) issued September 28, 1999.
8. United States Patent no. 6,775,828 (Delayed Uploading of User Registration Data) issued August 10, 2004.
9. United States Patent no. 5,851,117 (Building Block Training Systems and Training Methods) issued December 22, 1998.
10. See Troy Wolverton, *IBM Flushes Restroom Patent*, CNET NEWS.COM, <http://news.com.com/2100-1017-961803.html> viewed on January 6, 2005.
11. United States Patent no. 6,329,919 (System and Method for Providing Reservations for Restroom Use) issued December 11, 2001.
12. United States Patent no. 4,873,662 (Information Handling System and Terminal Apparatus Therefor) issued October 10, 1989.
13. See Craig Bicknell, *British Telecom: We Own Linking*, WIRED NEWS, Jun. 19, 2000, <http://www.wired.com/news/politics/0,1283,37095,00.html> (visited January 6, 2005).
14. 35 USC 122.
15. 35 USC 154(d).