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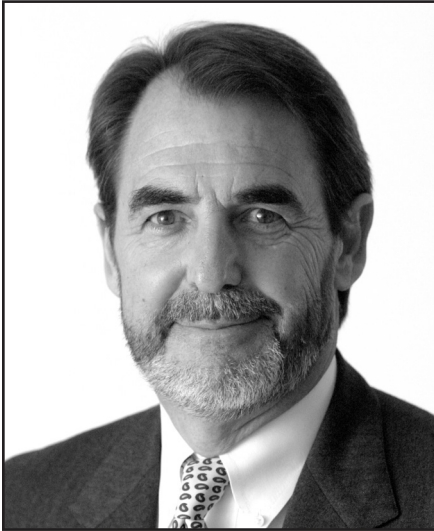
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The Licensing Corner



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BEING (UN)REASONABLE WITH AGREEMENT TERMS

Introduction

DRAFTING LAWYERS USE “STANDARD” LEGALESE all the time, often without thinking through the implications. A recent article got me thinking about several such instances.¹ I’ve chosen two oft-used terms: “Best efforts/commercially reasonable efforts” and “unreasonably withholding consent.”

How Reasonable Are “Best Efforts?”

Best efforts and *commercially reasonable efforts* often arise in negotiation drafts. When asked, most lawyers would argue that the common meaning of these terms is straightforward: “Best” means the highest possible efforts and “commercially reasonable” means efforts that within the commercial context would be reasonable.

Interestingly, some commentators argue that these distinctions are superfluous because judges will temper the “best efforts” to a standard that is “reasonable” by its nature. In other words, no one can be expected to go “above and beyond the call of duty.”² Put another way, if best efforts exceeds reasonableness then the contract language compels a party to do something that is unreasonable.

There is merit to that argument yet it might contradict another element of contract interpretation, namely, the intent of the parties. If the parties include “best efforts” then, even accepting the proposition that such demands would be unreasonable, it means that the parties intended such supra-normal efforts. However, I do agree that

California courts would probably squeeze “best” efforts down into a reasonable domain.

Avoid Both Standards? Perhaps this argument gets a bit too theoretical. I don’t want to wait for the courts to decide the meaning of language I have drafted, not to mention the embarrassment if my agreement becomes the focus of a lawsuit. My own view is to avoid *both* standards because they are qualitative and vague. “Best efforts” could be like the ever-shifting goalposts. “Commercially reasonable” gets further away from risks with qualitative standards but its reference to the commercial setting remains vague. Commercially reasonable for Google could bankrupt a burgeoning startup. Is this what you want?

We don’t work in a world where these standards can always be avoided (as an aside and least of all because the other side will insist on it—especially when the attorney across the table is a recently-minted attorney, as inexperienced lawyers seem willing to fight to preserve all language in favor of his or her client. But I digress).

One well-known approach is to specify the commercial framework in which reasonableness would be defined, *i.e.*, the specific sector. This approach might result in language such as “commercially reasonable efforts in the xyz sector for companies in a position similar to [party x].” Make sure that the “xyz sector” is narrowly defined.

Hang on a Minute. Better yet is to take a step back and answer a few questions: What are efforts in question? Why can’t they be measured by something more objective? Is some level of “effort” really required? Finally, what are the remedies, other than a breach (whether of the contract or of warranties)?

“Efforts” are usually found in sales and marketing efforts. “XYZ will use commercially reasonable efforts to [sell the product/engage distributors].” While it seems obvious that it is in XYZ’s best interests to do what it can to increase sales, motivations might be otherwise: The product might not sell well; the company might move out of this sector; the company might be cutting the deal for defensive reasons to keep your client’s products out of their market; or they acquire rights in competing products. “Efforts” of any type might not be sufficient to avoid or address such motivations or changed conditions (and putting aside good faith and fair dealing considerations).

With that in mind, we would simply attach and incorporate a sales/marketing plan with objective milestones. If our client had enough relative market clout we would include annual or even quarterly minimums. In all such scenarios, XYZ would have a contractual obligation to meet those objective criteria.

Remedies Offer Some Solace. In today’s digital world there are additional remedies for such failures. In an exclusive deal, exclusivity could be terminated. Your client could suspend or terminate quasi-

exclusive provisions—*i.e.*, where your client agrees not to engage with certain competitors in certain markets (and putting aside antitrust/competition claims).

By now, some of you are already drafting email replies to me that my suggestions are unrealistic: “efforts” provisions are unavoidable. In that case, I would fight for “commercially reasonable efforts” with industry limitations. Moreover, I suggest introducing a requirement that XYZ would provide a written explanation of why it was not reaching certain milestones.

Granting or Withholding Consent

Reasonableness rears its reasonably proportioned head in many, if not most, license agreements that require the licensor consent to certain actions by the licensee. The list is vast but it might include the grant of sublicenses, the production of manufactured products (*e.g.*, a plus *Snoopy*), the assignment of the agreement and so on. Commonly licensors have the choice of decisions in their “absolute and sole discretion” or not unreasonably withholding consent. To cut to the chase: If you represent the licensor, fight hard for the first option. Fight really hard.

Reasonableness and Consideration. In some jurisdictions, courts have linked reasonableness to the consideration licensor receives under the agreement.³ For example, potential injury to a continuing revenue stream would make withholding of consent reasonable.⁴ This might make sense. But put another way, it is dangerous: If a sublicense does *not* threaten the revenue stream then withholding consent could be unreasonable. Not a pretty picture.

There is not a lot of wiggle room here from a drafting perspective. On occasion, we have specified the grounds for reasonableness but only because of negotiation pressure to get a deal done. It might be an option worth exploring but it could get complicated.

Once again, take a step back to determine where consent is truly necessary. The three most important issues are sublicenses, assignments and manufacture of goods (or in the digital world, replication and redistribution of copyrightable content, whether photos, text or code).

Eliminate the Right of Sublicense. To the extent that your licensor-client has relative market power, there should not be any right of sublicense in the license grant. Period.⁵ The licensee can come to you with a request for a sublicense and you can write it, as a *license*, to the party that would otherwise be the sublicensee.

Obviously, that is not always viable. The licensee may have a network of distributors. In that case, “sole and absolute discretion” remains the best option. If that path is unavailable then the licensor can either approve the subdistributors with the initial license agreement (*e.g.*, a schedule) or specify the criteria by which subdistributor (or sublicensees) would be approved. Naturally, this position shifts the negotiations to the criteria.

Assignments are a No-no. I would take a similar, and possibly stronger, position with assignments.⁶ Knowing the devil with whom you

will be dealing is fundamental to any relationship. Absent the opportunity to prohibit assignments outright—or using the absolute and sole discretion standard—I would opt for a remedy of altering other terms (*e.g.*, exclusivity), suspension of certain provisions or outright termination.

Quality Control. Consent for products is usually the easiest case, usually because quality level defines pricing which governs royalty payments. Second, rights-holders have both a right and a duty to manage their trademarks and copyrights (although trademark licenses run a risk of an “accidental franchise”).⁷ Even the “consideration” standard mentioned above would admit such a basis.⁸

In these agreements, however, two issues should be addressed. First, it might be necessary to specify the criteria by which products are evaluated as well as the milestones, *e.g.*, initial concept, design, schematics, first and second prototype, manufacturing prototype, etc. Character licensors are usually able to avoid such requirements completely because their characters are so popular that they have the market power to reject such demands. Second, one should include a review procedure with review periods reasonably (that term again) linked to the time it takes to make such a review and a requirement of an explanation of the basis for rejection (or approval for that matter). We’ve seen five days (much too brief) up to five or so weeks (too long, unless QA tests are contractually mandated).

One might consider including disclosure and representations and warranties as to the production, both positive and negative. “Positive” reps might include compliance with technical specifications. “Negative” reps might include assurances that toxic materials have not been used. Pay attention also to disclaimers of fitness for a particular purpose, by the way.

As an aside, it is not clear what large-scale 3-D printing will do to license agreements. For example, who is responsible for QC on the materials being used? What are the remedies if 3-D printing is used in a B2B supply chain?

Conclusion: It’s (Almost) All About the Relationship

While drafting lawyers need to be aware that judges might take a dim view of the language in an agreement, ultimately most such deals come down to the relationship established between the parties to the contract. In other words, the agreement operates as a roadmap, rather than a tool for punishment, for the parties to maintain the relationship on good terms. Knowing that “reasonableness” can be based on some clear specifications helps that relationship. ◀◀

The views expressed in this article are personal to the author and do not necessarily reflect the views of the author’s firm, the State Bar of California, or any colleagues, organization, or client.

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Endnotes

1. My “inspiration” for this article was an ABA IP Litigation Section 2010 article by Hon-Man Lee, Lauren Koshalla and Albert Wai-Kit Chan of the Law offices of Albert Wai-Kit Chan, PLLC, which can be found at: <http://apps.americanbar.org/litigation/committees/intellectual/articles/092310-lee-korshalla-consent-license-agreements.html>. In particular, the article cites several interesting cases worth reading: *Speedplay v. Bebop*, 211 F.3d 1245 (Fed. Cir. 2000) (denial of assignment). *Rey v. Lafferty*, 990 F.2d 1379, 1393 (1st Cir. 1993) (rejection of merchandise based on the *Curious George* characters), which cites *Clifford Ross Co. v. Nelvana, Ltd.*, 710 F. Supp. 517 (S.D.N.Y. 1989), *aff’d without opinion*, 883 F.2d 1022 (2d Cir. 1989) (licensor’s approval of licensing agents). *County Choppers v. Olaes Enterprises, Inc.*, 497 F. Supp. 2d 541 (S.D.N.Y. 2007) (unreasonable delays in approvals).
2. See *Adams on Drafting* at www.adamsdrafting.com. While writing this column, he posted one on “best efforts” that prompted me to respond: <http://www.adamsdrafting.com/some-efforts-advice-that-i-wouldnt-give/>. Adams pretty much wants them all eliminated. While I feel his pain, it does not seem realistic for those of us in the drafting trenches.
3. We’ll put aside questions of defining “consideration” in the first place. See, for example, the ongoing discussion at *Adams on Drafting*, e.g.: <http://www.adamsdrafting.com/a-recital-of-consideration-from-heck/>.
4. *Speedplay* at 1251.
5. Limiting the right of sublicense also raises issues regarding the doctrine of “patent exhaustion,” a topic beyond the scope of this column.
6. Assignment provisions are a topic for another column. For example, I would specifically preclude assignments “by operation of law” to avoid an assignment by merger or acquisition. However, I have been told that some jurisdictions do not permit such a prohibition.
7. The State Bar of California has offered several webinars on this topic over the years. One you can find in the archives by the IP Section’s Licensing Interest Group can be found at: <https://calbar.inreachce.com/Search?q=accidental+franchise&search-Type=1>.
8. See *Speedplay* and the other cases cited at footnote 1 above.

LEGISLATION

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SB 34 (Hill D) Automated License Plate Recognition Systems: Use of Data

Existing law authorizes the Department of the California Highway Patrol to retain license plate data captured by license plate recognition (LPR) technology, also referred to as an automated license plate recognition (ALPR) system, for not more than 60 days unless the data is being used as evidence or for the investigation of felonies. Existing law prohibits the department from selling the data or from making the data available to an agency that is not a law enforcement agency or an individual that is not a law enforcement officer.

This bill would impose specified requirements on an “ALPR operator” as defined, including, among others, ensuring that the information the ALPR operator collects is protected with certain safeguards, and implementing and maintaining specified security procedures and a usage and privacy policy with respect to that information.

SB 34 has yet to be referred to a policy committee. ◀◀