UK Trade
& Investment

Negotiating Technology Transactions With US Businesses

UKTI Trade Services

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About the Author

Author:
Daniel Glazer

Fried, Frank, Harris, Shriver & Jacobson LLP
Tel (NY) +1.212.859.8674
Tel (UK) +44.20.7972.9600
daniel.glazer@friedfrank.com

Daniel Glazer is a partner in the Technology Transactions Group at Fried, Frank, Harris, Shriver & Jacobson LLP. His practice focuses on domestic and cross-border intellectual property and information technology transactions, such as licensing, outsourcing, distribution, development, consulting, manufacturing, supply, sponsorship, marketing and transfer arrangements, as well as the IP/IT aspects of mergers and acquisitions, joint ventures, securitizations, credit arrangements and other complex corporate transactions. He is a graduate of Harvard Law School and Dartmouth College.

His professional biography is available here, and you can download his contact Vcard here.

Dan can be reached at daniel.glazer@friedfrank.com, on Linkedin here, at the firm's New York office at +1.212.859.8674, or through the firm's London office at +44.20.7972.9600.

Introduction

Your UK-based technology company has reached a deal with a US-based business partner, subject to finalizing the contract. The US company insists on using its form agreement, which contains numerous unfamiliar terms and concepts. You don't want to risk losing the deal by taking a heavy hand to the contract, but likewise want to avoid exposing your company to needless risk.

This publication aims to highlight ten pitfalls UK companies should avoid when entering into agreements with US-based companies for the licensing or development of software and other technology. These risks can be mitigated, but only if your company is sensitive to these considerations when negotiating the contract.

All US laws are not created equal

Although for simplicity's sake this article will refer to "US law," for the most part there is no single body of US contract law. Rather, each of the 50 US states has its own contract law, and your US partner likely will insist that the contract is governed by the laws of a US state with which that company is familiar. The larger US commercial centers, such as the states of New York and California, tend to have better-developed contract laws.

The contract laws of the various states generally adhere to common themes, but each state's laws have their own idiosyncracies. For example, New York state law allows parties to select New York law to govern commercial contracts that bear no relation to New York, but only if the contract is worth more than US$250,000. As another example, California state law offers broad protection to technology developers, in some circumstances interpreting IP transfer language in a manner that recognizes a potentially unintended employment relationship between California technology developers and companies commissioning technology development.

Indemnification is expected

US commercial litigation is relatively common, in part because unsuccessful US litigants usually are not required to pay the prevailing party's legal costs. Accordingly, there is a particular focus in US contracts on obtaining financial protection in the event of litigation claims.

When contracting with a US company, your company most likely will be asked to defend the US company against certain types of claims and indemnify it for related losses. Every contract is different, but common topics for indemnification include breach of confidentiality obligations, violations of applicable law, damage to tangible property, and personal injury or death.

Indemnification for intellectual property infringement claims asserted by third parties is a key provision in technology contracts, as US intellectual property litigation is particularly widespread and costly. Technology recipients typically will ask for an IP infringement indemnity from their providers, but the provider may seek to limit, eliminate or even reverse the indemnity obligation when the alleged infringement was the recipient's fault (such as where the alleged infringement was caused by the recipient's unauthorized use or modifications of the provider's technology, the recipient's failure to implement a work-around, or the provider's compliance with recipient's instructions).

In all events, the technology provider should consider reserving the right to replace, modify, or obtain a license for the recipient to use the allegedly infringing technology, as well as the right to terminate the recipient's right to use the allegedly infringing technology as an "option of last resort."

Ensure appropriate confidentiality protection

US laws governing confidentiality obligations can be tricky. Your company should carefully consider the ramifications of any proposed limit on the duration of your partner's obligation to protect your valuable confidential and proprietary information (characterized as "trade secrets" under US law). Trade secret protection exists indefinitely under US law unless the information is disclosed without a duty of confidentiality or independently discovered; the long-secret Coca-Cola formula is perhaps the best-known example. Agreeing to term-limited confidentiality obligations for your company's trade secrets creates a significant risk that your company will lose the ability to protect the information.

However, attempts to extend perpetual confidentiality obligations to confidential information that does not qualify as a trade secret may be unenforceable under the laws of some US states. Further, some companies object to perpetual confidentiality obligations as a matter of corporate policy.

Accordingly, it may be appropriate to draft your company's agreement in a manner that accounts for both considerations; for example, the confidentiality obligations could remain in force for a pre-determined number of years, except that obligations with respect to trade secrets survive indefinitely. If the counter-party will not agree to any confidentiality obligations that are perpetual, your company will need to consider the risk of disclosing its trade secrets to a company that eventually may have no legal obligation to protect them.

Beware of joint ownership

Joint ownership of technology commonly is viewed as an efficient way to avoid difficult negotiations over intellectual property rights. However, joint ownership can result in uncertainty as best and, at worst, hinder your company's ability to use and commercialize the jointly-owned technology.

The rules of joint ownership vary not only among the different types of intellectual property (e.g., patents, copyrights, trade secrets and trademarks), but also among various countries. Under US law, each joint copyright owner may commercialize the copyrighted work without the other joint owners' consent, but must account for licensing royalties received and may not destroy the value of the work. This is different than English law, which states that joint copyright owners cannot exploit their rights in the work without the other joint owners' consent. It also is different than the US rule on joint patent ownership, which is that joint patent owners have no duty to account to the other joint owners for licensing royalties.

Joint owners can agree to modify these rules in their contract, but they likely will apply by default if the contract specifies without further elaboration that the parties are "joint owners" of developed technology.

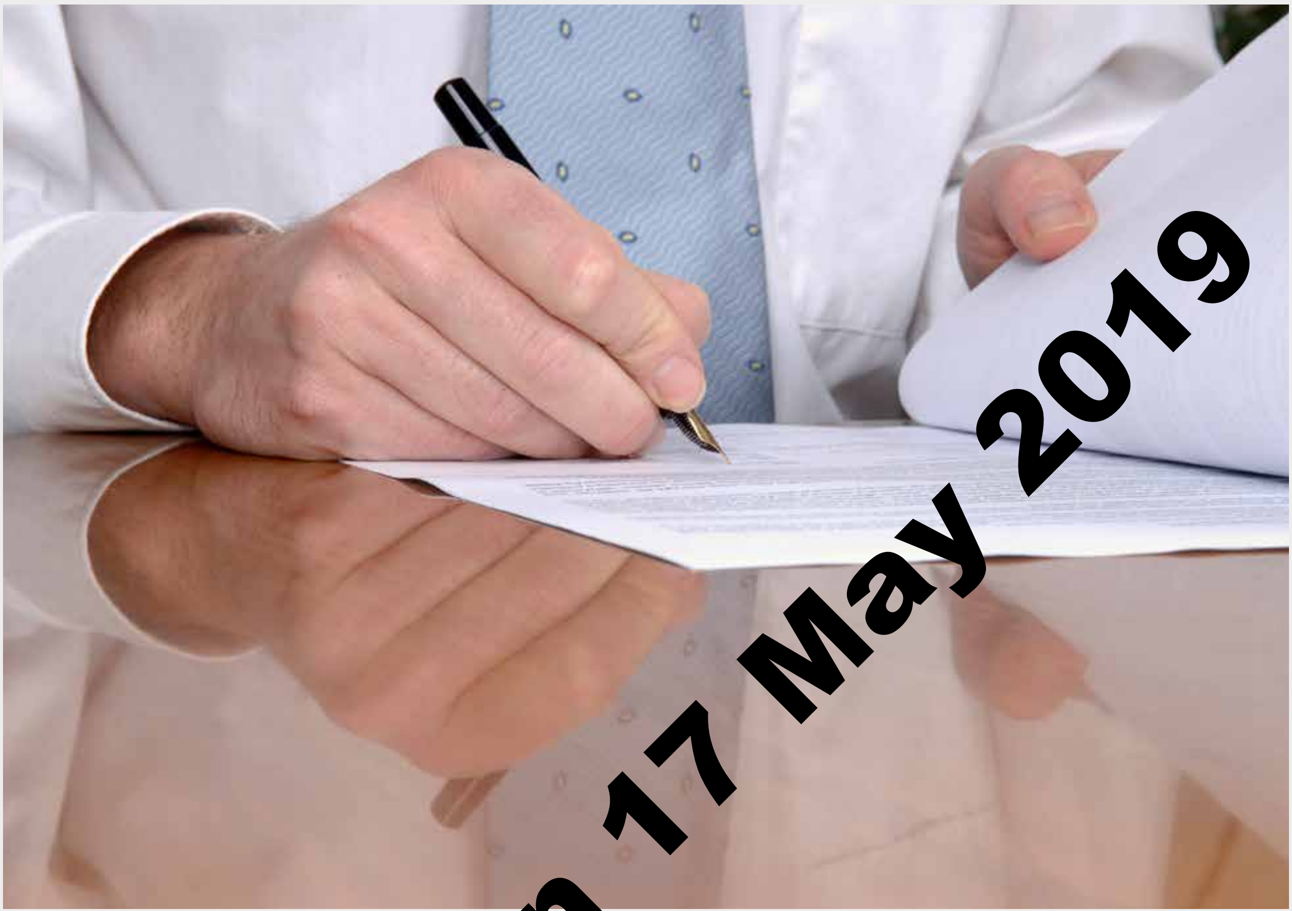
Avoid the potential traps of “work made for hire”

Under US law, the “work made for hire” concept is a common means of vesting copyright ownership in a party commissioning technology development from its employees or independent contractors. The copyright in a “work made for hire” is owned not by the creator of the work, but rather by the creator’s employer or other party that commissioned it. The doctrine is quite nuanced when applied to non-employee contractors, and the failure to get it right can provide the basis for an eventual infringement suit against the commissioning party or its customers.

Even if parties state in an agreement that all deliverables are “works made for hire,” only certain works qualify if created by a non-employee contractor. Crucially for companies commissioning technology development, software code generally cannot be a “work made for hire” when created by a contractor.

To ensure your company obtains all rights in deliverables it commissions from US contractors, prudent drafters should consider using additional language that assigns to your company all of the contractor’s rights in those deliverables. However, there are incentives under US law to characterize as much technology development as possible as a “work made for hire.” In particular, “works made for hire” are exceptions to a developer’s irrevocable right under US law to terminate an assignment of copyright in software code after 35 years.

As a result, it may be appropriate to include transfer language stating that all technology the contractor develops is a “work made for hire” to the extent it qualifies under US law, and that the contractor’s rights in that technology are assigned to the commissioning party to the extent the work does not qualify.



Use the present tense

Language intended to assign rights to your company should reflect a present transfer of rights (the developer "hereby assigns its rights"), not a future promise to transfer (e.g., "will assign" or "agrees to assign"). Under the latter formulation, your US partner's failure to deliver the promised assignment may result in a breach of contract claim, but not necessarily ownership of the relevant copyright or other IP rights.

This distinction figured prominently in a case recently decided by the US Supreme Court, whereby a Stanford University research fellow signed an agreement in which he "agreed to assign" to Stanford his rights in any subsequently developed inventions. As part of his research activities, he began visiting the laboratories of Cetus Corp., where he signed an agreement in which he "did hereby assign" to Cetus any inventions he created as a consequence of his access to Cetus' facilities.

In June 2011, the US Supreme Court affirmed a lower court's ruling that Stanford's "agree to assign" language was merely a promise to assign – a promise that the research fellow could not keep as a result of his subsequent assignment of rights to Cetus. Although this is clearly a worst-case scenario, it highlights the importance of drafting the transfer of rights in a manner that will withstand scrutiny under US law.

Protect against your partner's bankruptcy

US law offers protection against a technology licensor's attempts to terminate a licensee's rights following the licensor's bankruptcy filing. Under US bankruptcy law, technology licensees typically can retain their rights in the licensed technology, as long as they continue to pay when due all applicable license fees and otherwise comply with the terms of the agreement. The relevant provision of the US bankruptcy code (Section 365(n)) omits trademark licensees from this protection, although some courts have refused to allow licensors to terminate licensees' rights when licenses of technology and trademarks are inextricably bundled in the same agreement.

Your agreements with US technology licensors should include an acknowledgement that Section 365(n) applies to all licenses granted in the agreement, and that your company may elect to retain its rights in all licensed intellectual property and technology in the event of the licensor's bankruptcy. If that bankruptcy actually occurs, your company should consult a US-qualified bankruptcy lawyer to ensure appropriate and timely filings are made with the relevant bankruptcy court.

Pay attention to source code escrows

From time to time, it may be necessary for your company to ensure that source code and related items for certain key in-licensed software are placed in escrow. One of the typical events triggering release of the escrow materials is the licensor's bankruptcy or insolvency. While escrow arrangements generally are enforceable under US law, the nuances of US bankruptcy law require special attention when contracting with a US licensor.

Some source code escrow agreements purport to grant a license to source code that is effective only if the release condition occurs. However, US bankruptcy courts may characterize such a license grant, which is contingent on the licensor's bankruptcy, as an unenforceable transfer of assets from a bankrupt entity.

To better ensure the effectiveness of the escrow arrangement, the escrow agreement should include a present grant of license to the source code. The licensor may object on the basis that it has no intention of allowing your company to use the source code unless a bankruptcy or other release event occurs, but of course your company cannot obtain the code (and thus receive the benefit of the license grant) until the escrow agent releases it.

Another way to address the concerns presented by US bankruptcy law is to avoid the impact of bankuptcy altogether, typically by expanding the scope of release events to include "pre-bankruptcy" warning signs of financial distress, such as licensor's failure to pay bills as they come due or concerns expressed by independent financial auditors.

Finally, your company should consider whether bankruptcy and other release events should be exceptions to any agreement to not hire or contract with the licensor's software developers and programmers. The source code may be quite difficult to utilize in practice without the ability to consult the individuals who know it best.

Anticipate potential acquisitions

Maintaining the transferability of third-party contracts allows for flexibility in business planning and can help your company become a more attractive target for potential investors and acquirors. While agreeing to certain prohibitions on assignment may be unavoidable, UK companies should be aware of certain restrictions on the assignability of technology licenses under US law that may be unexpected.

For example, some US courts view mergers and similar business combinations as violating assignment prohibitions in technology license agreements, but not in other types of commercial contracts. Further, under US law a non-exclusive technology licensee generally may not assign its rights without the licensor's consent if the license agreement is silent on transferability; several US courts have extended this rule to exclusive technology licenses. By contrast, if the license agreement is silent a technology licensor typically may assign its rights without the licensee's consent.

Accordingly, to avoid future uncertainty and potentially costly consent rights or litigation, it is advisable to specify in the agreement the types of business combinations that are permissible.

Anticipate potential sales

Large companies often require their technology providers to assist them in planning for their potential future divestiture of subsidiaries and other affiliates. So-called "divested entity" provisions are becoming increasingly common in US agreements, whereby a large company receives the right to use certain technology or services on behalf of divested affiliates, or for divested affiliates themselves to continue to use the licensed technology or services following a sale. The contracting company also may request commitments from its technology providers to enter into negotiations for new agreements with divested affiliates.

If your company is asked to provide this flexibility, make sure the company with which you are contracting remains responsible for the divested affiliate's and the acquiror's actions; you also may consider retaining the right to audit their compliance with the agreement. Perhaps more importantly, ensure your company will be adequately compensated for the additional benefits this arrangement will provide to your partner's divested affiliate and the acquiror.

Conclusion

Business moves quickly in the digital age, and there is understandable reluctance to potentially lose a deal due to an excess of caution over legal terms. However, as the saying goes, an ounce of prevention is worth a pound of cure. Having a qualified technology lawyer conduct at least a brief review of your company's agreement ultimately can make all the difference.

Other sources of information

UK Trade & Investment

UK Trade & Investment is the Government Department that helps UK-based companies succeed in the global economy. We also help overseas companies bring their high-quality investment to the UK's dynamic economy, acknowledged as Europe's best place from which to succeed in global business. UK Trade & Investment offers expertise and contacts through its extensive network of specialists in the UK, and in British embassies and other diplomatic offices around the world. We provide companies with the tools they require to be competitive on the world stage.

For information on the services available to you, or to locate your nearest International Trade Team, please visit our website: www.ukti.gov.uk

UK Trade & Investment has teams located in the British Embassy in Washington DC and eight British Consulates around the United States. For more information on our offices, please visit: www.ukinusa.fco.gov.uk

U.S. States

If you are looking for advice on establishing a presence in the United States, SelectUSA is a programme under the US Department of Commerce that explains the benefits and puts you in touch with relevant US Economic Development Agency contacts: selectusa.commerce.gov

In addition, many US States maintain offices in the UK or elsewhere in Europe. The US state governments are a good source of advice and information about business conditions in their states. Please visit the Council of the American States in Europe website for more information: www.case-europe.com

U.S. Lawyers

A list of American attorneys based in the UK is available on the US Embassy website: www.usembassy.org.uk

The American Bar Association website provides extensive lists of law firms across the United States. You can search by geography, area of practice or just browse the list of law firms to search for ABA-certified lawyers by state and by specialty: apps.americanbar.org/legalservices/lris/directory

Select U.S. Government Resources

All US federal agencies
www.usa.gov/directory/federal/index.shtml

Alcohol and Tobacco Tax and Trade Bureau (TTB)
www.ttb.gov/index.shtml
Regulates Alcohol & Tobacco

American Embassy, London
london.usembassy.gov
Represents US diplomatic interests abroad

Consumer Product Safety Commission (CPSC)
www.cpsc.gov
Regulates Consumer Products

Customs & Border Protection (CBP)
www.cbp.gov
Regulates and facilitates international trade, collecting import duties, and enforcing US regulations, including trade, customs and immigration

Federal Trade Commission (FTC)
www.ftc.gov
Presides over Dissatisfaction with Business Practices

FedWorld
www.fedworld.gov
Online locator service for a comprehensive inventory of information disseminated by the US Federal Government

Food & Drug Administration (FDA)
www.fda.gov
Regulates Cosmetics & Drugs, Food, Medical Devices, Veterinary Medicines & Electronic Product Radiation

Internal Revenue Service (IRS)
www.irs.gov
Responsible for tax collection and tax law enforcement

National Institute of Standards and Technology (NIST)
www.nist.gov
Promotes US innovation and industrial competitiveness by advancing measurement science, standards, and technology in ways that enhance economic security and improve quality of life

Occupational Safety and Health Administration (OSHA)
www.osha.gov
Assures safe and healthful working conditions by setting and enforcing standards and by providing training, outreach, education and assistance

Small Business Administration (SBA)
www.sba.gov
Provides support to entrepreneurs and small businesses

United States International Trade Commission (USITC)
www.usitc.gov
Provides international trade statistics and the Harmonised Tariff Schedule

United States Patent and Trademark Office (USPTO)
www.uspto.gov
Issues patents to inventors and businesses for their inventions, and trademark registration for product and intellectual property identification

UK Export and International Business Development Resources

British American Business, Inc.
www.babinc.org
Leading transatlantic business organization, dedicated to helping companies connect and build their business on both sides of the Atlantic

British Standards Institute
www.bsigroup.com/en
Multinational business services provider that advises on how to meet technical standards and approvals procedures

Business Link
www.businesslink.gov.uk
UK government's online resource for businesses, providing guidance on regulations and to access government services.

Department for Business Innovation and Skills (BIS)
www.bis.gov.uk
UK department that supports sustained growth and higher skills across the economy

Export Control Organisation
www.businesslink.gov.uk/exportcontrol
Helps businesses navigating export procedures and documentation

Export for Growth Guide
(Click here for PDF Guide)
SME export guide produced by Forum of Private Business in conjunction with UK Trade & Investment

HM Revenue & Customs
www.hmrc.gov.uk
UK department responsible for the collection of taxes

UK Export Finance
www.ukexportfinance.gov.uk
Export credit agency that provide assistance with credit insurance and financing products

Company Information

Better Business Bureau
www.bbb.org

Dun and Bradstreet
www.dnb.com

Oanda
www.oanda.com
Foreign exchange rates, current and historical.

Nasdaq
www.nasdaq.com

US Securities and Exchange Commission
www.sec.gov

Forbes Magazine
www.forbes.com/forbes

US News & World Report
www.usnews.com

Solutions for Business

Funded by UK Government

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