Essentials and pitfalls in drafting IP provisions in commercial agreements

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IP provisions in commercial agreements don't get the same kind of attention or discussion as patent litigation or prosecution, but they are every bit as essential to protecting a company's IP.

On a day-to-day basis, much of the work done to protect a company's intellectual property is done through its various commercial agreements. These include: nondisclosure agreements, joint development agreements, supply or vendor agreements, service agreements and manufacturing agreements.

Despite the importance of the IP implications of commercial agreements, when companies and seasoned IP professionals talk about IP protection, they typically refer to one of the two main buckets — IP procurement and IP enforcement. Even patent practitioners often think of themselves as either patent prosecutors or litigators. But most companies will rarely be involved in a high-stakes patent infringement lawsuit. Even companies with large patent portfolios may see only a handful of new patent applications or issued patents per month.

Commercial agreements that touch on IP are much more common.

Frequently, companies may rely on form or stock agreements and give little thought to the ramifications. Or a company may receive a draft agreement from the other party and fail to review it carefully enough. But the nature of the IP concerns in a commercial relationship are not typically one-size-fits-all. Depending on the posture of your company or client, the complexity of the project or relationship and the nature of the IP involved, the contract needs will be different.

Moreover, the stakes are often just as high as any patent infringement lawsuit—quickly agreeing to the other party's draft agreement may bind your company or client to onerous or impractical IP restrictions. Even worse, it could inadvertently result in turning over critical IP rights. There are some basic steps, however, that a practitioner can take in reviewing the different types of basic IP provisions in a commercial agreement. It can head off future disputes, make contract compliance as smooth as possible and ensure the protection of your company's or client's intellectual property.

Confidentiality Provisions

Confidentiality provisions are one of the most common types of provisions in a commercial agreement. Whether as a separate nondisclosure and confidentiality agreement or as a section in a larger agreement (like a master services or joint development agreement), confidentiality agreements are vital for protecting a company's intellectual property that is still in development or is protected via trade secrets.

For example, if a company is still developing an innovation, it may not have filed patent applications yet or may not be ready to file applications. Or the parties to an agreement may contemplate that their collaboration will result in developing new inventions. Apart from deciding who will own what inventions, as an initial matter the parties need to agree to keep them confidential in the meantime to avoid any loss of patent rights. Confidentiality provisions, however, can vary in a number of ways depending on the nature of the agreement.

First, confidentiality provisions can (and should) vary depending on whether your company or client will be the primary disclosing party – the party disclosing its confidential technology details to the other party – or the primary receiving party.

Considerations for disclosing parties

If your company or client will be the primary disclosing party, you may want to have the following:

A broad definition of what is "confidential"
For example, you may wish to treat everything disclosed as presumptively confidential unless indicated otherwise in writing or provide that anything that someone in the field would reasonably understand to be non-public is confidential. Or you may wish to define certain categories of information as presumptively confidential (such as prototypes, specifications, formulation information or schematics).

No labelling requirement for confidential information
If your company or client anticipates communicating a large amount of information – especially if you anticipate informal communications between engineers or scientists – it may not be practicable to label every item as confidential. Additionally, an engineer or scientist may not think about legal issues and may neglect to label a critical item as confidential.

Detailed use and non-use provisions
Many confidentiality provisions specify that the receiving party may not use confidential information for any purpose other than related to a project or relationship. It is advisable to spell out specifically that the receiving party may not:

1. file any patent applications disclosing or relating to any disclosed confidential information;
2. commercialise any product embodying any disclosed confidential information without written approval; and
3. disclose any confidential information to any third party, including vendors or suppliers.

Limit access to confidential information
The agreement may provide that only certain listed people can have access, or at the very least only persons having a "need to know" to perform their obligations relating to the project or relationship. The agreement may also provide a specific mechanism for exchanging information, like through only one point person, or through a portal or shared drive.

Considerations for receiving parties

Conversely, if your company or client will be the primary receiving party, you may have different concerns and may want the following provisions:

Clarity and definiteness in "confidential information" definition
You may want to insist on requiring that all confidential information must be labelled and any orally-disclosed confidential information must be designated in writing within 30 days. At the very least, these requirements would apply to defined categories of confidential information.

Avoid over-inclusive confidentiality provisions that put the onus on the receiving party to disprove confidentiality. Typically, a confidential agreement will provide various exceptions to the definition of confidential information, such as for information that was already publicly available. If your company or client is the primary receiving party, however, you may not want to bear the burden of proving that disclosed information falls within an exception.

Resist the urge to give confidentiality little thought because your client or company is not disclosing any information. Even the primary receiving party may unexpectedly develop a confidential innovation relating to the project. But more importantly, you likely will not want to tie your company or client to overly-burdensome requirements such as non-use limitations and confidentiality audits.

Second, the complexity of a confidentiality agreement may vary with the complexity of the overall project or relationship between the parties. For example, if the shared information is particularly sensitive – trade secret or highly proprietary technical information – you may want to consider additional safeguards. They include:

1. putting tight constraints on how information is shared, including providing that information can only be shared through a specific procedure and prohibiting oral communications;
2. specifying that certain information will not be shared and if inadvertently shared will be immediately destroyed or returned. Also provide strict return-or-destroy provisions, whereby the disclosing party can at any time ask for the return or destruction of information; and
3. providing audit rights for the disclosing party, so that the disclosing party can confirm that the information is being kept confidential.

Another consideration is that some projects may require that the receiving party be able to share information with a third-party vendor, supplier or manufacturer. The confidentiality provisions need to address how the information can be shared with that third party and under what constraints.

Yet another consideration is that sometimes, the parties may have already informally started working together without a confidentiality agreement in place. In that instance, you may need to provide that any information already disclosed will also be kept confidential and provide a rep or warranty that the information has not already been disclosed. Depending on the nature of the agreement, the parties can also negotiate the term of the confidentiality agreement, how long confidential information must be protected after termination and potentially exclusive dealing provisions.

IP ownership provisions

Another common type of IP provision in a commercial agreement is an IP ownership provision. The need for this type of provision obviously arises in a joint development agreement, in which each party is developing some aspect of a new product, but it also arises in a supply or manufacturing agreements, where one party agrees to make a product for the other.

It may be tempting to say that the parties will agree to each own whatever they develop. But that approach is only likely to work in situations where there is no vital IP being developed and no patent applications filed later. Otherwise, there would likely be disputes over ownership of an invention conceived by one party but which incorporates confidential information or background IP of the other party, and jointly developed inventions.

If the parties do anticipate that there might be new inventions arising from the project or relationship, the best practice is to delineate carefully who will own what. There are several approaches to doing so:

Primary party owns everything
For for a normal supply or manufacturing agreement, where one party is merely hiring another company to build or develop something according to predetermined specifications, the parties may agree that the hiring party owns all newly-developed IP, essentially as work for hire. If the situation is more nuanced, such as where the supply or manufacturing company is given only loose requirements and is being asked to invent a new product, the parties could agree that one or the other owns all newly-developed IP, but with an exclusive licence back to the other party within a certain field – perhaps sectors in which the hiring party is not engaged.

Dividing ownership by subject matter
If one party is primarily responsible for developing one aspect of the product like the materials or mechanical components and another party is primarily responsible for developing a different aspect like a specific component or electronics, ownership of new IP could be assigned based on those categories.

Dividing joint IP
In this approach, the parties may specify that each party owns all newly-developed IP that (1) is developed solely by one of that party's employees and (2) does not incorporate and is not based on the other party's pre-existing IP or confidential information. Then, the parties can decide how to divide any joint IP that does not fall into either party's ownership (or may anticipate that that there will be little to none).

Joint ownership of joint IP
Depending on the relationship between the parties and whether the parties envision a long-term partnership and truly sharing the newly-developed IP (such as two competitors who pool patents for their common benefit), the contract may provide for joint-ownership of any newly-developed IP. This is relatively uncommon, however, due to the legal ramifications of joint ownership, such as the ability of each joint owner to grant licences without the consent of the other. The parties may alternatively assign any joint IP to a newly-created jointly-owned entity, which in turn can license each of the parties.

For any IP ownership provision, the primary concern is usually certainty. The parties usually seek to avoid future disputes over IP ownership, while at the same time balancing whether drafting an overly-complex agreement is justified based on the anticipated project or relationship.

Other provisions

Another category of provisions in a commercial agreement that can impact a company's intellectual property are those dealing with third-party IP infringement or misappropriation claims. For example, a supply agreement may provide that the supplier represents and warrants that the product does not infringe upon any third-party intellectual property (typically limited to "knowing" infringement). This is frequently coupled with an indemnification provision, whereby the supplier will agree to indemnify the purchasing party from any third-party IP infringement or misappropriation claims relating to the product. These two provisions complement each other. If it is shown that the supplier was aware that its product infringes a third party's patent, that would constitute a breach of the agreement with its associated remedies. Meanwhile, the indemnification provision would typically require the supplier to reimburse the purchaser for any damage caused by the third party's infringement claim. But even these provisions can vary depending on the specific concerns of the parties and their relationship. For example:

- The indemnification provision may be narrow and just reimburse the indemnified party for actual judgments of IP infringement or misappropriation (relatively uncommon). Or, the indemnification provision may be relatively broad

and reimburse the indemnified party for any costs (including attorney fees) associated with any "claim" or "allegation" of IP infringement or misappropriation.
- The indemnification provision may also provide that the indemnifier will step in and defend the indemnified party at its own cost or otherwise provide who will defend the lawsuit and how involved the indemnified party may be.
- The indemnification provision may or may not have a cap, such as limiting any indemnification to the amount of money paid by the indemnified party to the indemnifier. These types of caps usually have exceptions, at the very least for any wilful or intentional infringement or misappropriation, and often no cap for intellectual property infringement damages at all.
- The indemnification provision may have exceptions for if the purchasing party makes unauthorised modifications to the product or uses it in an unauthorised manner, or if the infringement allegations are solely related to product specifications provided by the purchaser.
- The indemnification provision may also set out what the supplier must do to provide an alternative, non-infringing product. For example, the agreement may provide that the indemnifier must provide an alternative product by (1) designing around the patent at issue, (2) obtaining a licence at no additional cost to the purchaser, or (3) locating an acceptable non-infringing substitute product.

All told, the breadth and extent of indemnification provisions usually depend on the relative bargaining strength of the parties, the nature of the project and the role of each party. The financial implications of defending against an infringement lawsuit or pulling a product from the market are also a factor. At the end of the day, any indemnification provision is only effective if the parties are confident that the indemnifier will stay in business when the time comes, and have the financial ability to satisfy the indemnification obligations.

Conclusion

For nearly any commercial relationship involving technology, there is the potential for intellectual property issues to arise. Whether it involves sharing proprietary information, working together to develop a new product, or simply purchasing a product from a supplier, the day-to-day commercial agreements that cover these relationships can be every bit as important as the patent applications a company files or its patent enforcement policy. As such, these types of agreements should be drafted with the specific issues and project involved in mind, understanding that there is no one-size-fits-all solution.

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