Managing the risks of intellectual property interdependence in the age of open innovation

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5.1 INTRODUCTION

Our globalized flat world\(^1\) tends to intensify the exchanges and interactions between the market players. It mirrors the movement of open innovation which is characterized by the increased use of third party knowledge for the purpose of enriching a company’s internal innovation (\textit{inbound open innovation}), and by the continuing search for new markets and channels of distribution for the company’s own innovation (\textit{outbound open innovation}).\(^2\)

In a world of open innovation, innovation does not result from the internal efforts of companies, but from the network.\(^3\) Today’s networked and interconnected economy therefore perfectly expresses the paradigm of open innovation.\(^4\)

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\(^1\) By reference to the celebrated book of T.L. Friedman, \textit{The World is Flat} (3rd edn, 2007).


\(^4\) It is consequently not surprising that the European Union treats open innovation in its ‘Digital Agenda’ program, see http://ec.europa.eu/digital-agenda/en/entrepreneurship-innovation/open-innovation; see the report of J. Vallat, \textit{Intellectual Property and Legal Issues in Open Innovation in Services}
The intensive interactions between the market players which are at the core of the open innovation ecosystem generally materialize in a multiplication of contractual relationships by which companies integrate in their products and services the intellectual assets (and intellectual property rights) of third parties and also offer their own intellectual assets to the market according to (contractual) rules and principles that they choose. This system makes it possible to capitalize on and benefit from the expert knowledge and experience of other entities, and can therefore contribute to an optimal allocation of corporate and societal activities and resources. These interactions can, however, generate risks which result from the interdependence that such interactions generate. The goal of this chapter is to explore some of the consequences of this network of intellectual property interdependence in the creation and in the use of innovation and to assess how the risks could be managed.

5.2 RISKS OF INTELLECTUAL PROPERTY INTERDEPENDENCE IN THE ERA OF OPEN INNOVATION

While open innovation networks obviously create promising opportunities, they can also generate risks which can be quite diverse.6


5 One avenue for fostering accessibility and sharing opportunities is to adopt an open licensing (open content / open source) strategy; open innovation however does not necessarily mean that the knowledge which is generated is offered for free to third parties under open licensing terms; two categories of open innovation have thus been identified: open boundary innovation which is designed to source new technology and concepts broadly without surrendering control of the innovation process; and open source innovation which is a more radical model that views the source of much innovation as originating in the collective knowledge and motivation of anonymous users; see J. Euchner, ‘The Uses and Risks of Open Innovation’ (2013) 56(3) Research-Technology Management Journal 49.

6 See J. de Werra, ‘Keeping the Genie of Licensing Out of the Bottle: Managing Inter-Dependence in Licensing Transactions’ (2014) IIC 253 (from which some developments addressed in this chapter are derived); on open innovation from an intellectual property perspective, see generally J. Brand and S.
From an intellectual property perspective (on which this chapter will focus), risks generally result from the interdependence that open innovation can generate. The focus will here be on outsourcing of research and development (R&D) activities (see 5.2.1), joint generation of innovation (5.2.2) and the use of third party’s intellectual property assets (5.2.3).

**5.2.1 Interdependence from Outsourcing R&D**

One aspect of open innovation is to outsource R&D. This contributes to the creation of niche markets of highly specialized companies and service providers which offer their creativity (and R&D expertise) to the market and to their clients. Depending on the structure of the relevant market, clients operating in the same industry and market – who are thus direct competitors – can (or sometimes even have to) turn to the same provider of R&D services because of their unique expertise. This can raise difficult issues of intellectual property dependence, also because the allocation of intellectual property rights (IPRs) between the service provider and its client may be complex (if not adequately regulated by contract). It is indeed established that clients are also the source of quite valuable innovation. This complexity can be illustrated by reference to the dispute which arose between two Formula One teams and the company which provided them highly specialized services, in other words, wind tunnel aerodynamic testing and development.


7 O. Gassmann, ‘Opening up the Innovation Process: Towards an Agenda’ (2006) 36(3) R&D Management 224; ‘Technical service providers such as engineering firms and high-tech institutions have become more important in the innovation process’.

8 For an example, see C-32/08 FEIA v. Cul de Sac Espacio Creativo SL, CJEU [2009] ECR I-05611.

9 As admirably demonstrated by E. von Hippel in his (numerous) publications on user innovation and, more generally, on the sources of innovation, see E. von Hippel, The Sources of Innovation (Oxford, Oxford University Press, 1988), available at http://web.mit.edu/evhippel/www/sources.htm.

10 Force India Formula One Team Ltd v. 1 Malaysia Racing Team SDN BHD and others [2012] EWHC 616 (Ch) (21 March 2012); Force India
One of the issues in this case was to distinguish between the personal skill and knowledge of the employees of the service provider and the corporate trade secrets of its clients. The concern was expressed that the development contract should not ‘unduly restrict the ability of Aerolab’s employees from making use of their skill and knowledge, even if that skill and knowledge had been enhanced by information that they had acquired in the course of working on the Force India project’.\textsuperscript{11} This dispute shows the difficulties in defining the scope of protection of trade secrets in an era characterized by employee mobility and by open innovation models. This is a challenge that will also have to be faced and solved in the European Union which is about to harmonize the protection of trade secrets as resulting from the Proposal that was submitted in November 2013.\textsuperscript{12}

5.2.2 Dependence from Joint R&D

Open innovation networks also imply an intensification of the cooperation between entities in joint research and development activities. Joint innovation activities are likely\textsuperscript{13} to lead to joint ownership of the intellectual property rights on the results which would be generated in the course of the joint research project. While joint ownership of intellectual property rights is anything but a new phenomenon in the intellectual property landscape, its lack of harmonization at the international level, and even at the national level, is a challenge that will also have to be faced and solved in the European Union which is about to harmonize the protection of trade secrets as resulting from the Proposal that was submitted in November 2013.\textsuperscript{12}

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\textit{Formula One Team Ltd v. Aerolab SRL and others} [2013] EWCA Civ 780 (July 2013).
\textsuperscript{11} \textit{Force India Formula One Team Ltd v. Aerolab} [2013] EWCA CIV 780, para. 61.
\textsuperscript{12} Proposal for a Directive of the European Parliament and of the Council on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure, COM/2013/0813 final; 2013/0402 (COD) (28 November 2013); this project is still on-going as of the time of this chapter.
\textsuperscript{13} This will depend on contractual solutions and on the applicable regulatory framework (particularly if the cooperation is between private and public institutions).
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level, remains highly problematic. The constraints and specificities of national intellectual property regimes are numerous and clearly do not meet the legitimate expectations of global innovation networks where innovation is shared and also co-owned.

On this basis, it is clear that joint ownership of traditional categories of IPRs (particularly copyrights and patents) may already be difficult to manage, particularly in a transnational perspective. The management can become even more complex when dealing with more evanescent forms of intangible assets, and particularly with trade secrets. What rules shall apply in the case of jointly generated trade secrets, which is presented as a potential new business model in the draft Directive on the protection of trade secrets? What shall each co-owner be in a position to do with its share of the joint knowledge? Shall each of the co-owners be in a position to independently transfer its share of the joint knowledge to a third party or license it out to a third party? Shall each of the joint owners be in a position to initiate judicial action against a third party for misappropriation of trade secrets? Ideally these issues should also be regulated in order to create an adequate legal regime of protection of trade secrets, knowing that trade secrets, similarly to other types of IPRs, are frequently the product of joint efforts made by several (generally many) individuals and are no longer the creation of an individual (and lone) creator.

14 It is not infrequent that the legal regime of co-ownership of intellectual property rights differs from one type of intellectual property right to another within one national legal system.

15 As evidenced by the special issue of the LES journal Les Nouvelles on joint ownership (December 2012), see the introduction to this special issue by S. Kim and V. Lipton, ‘Joint Ownership of IP Around the World’, at 250 (who indicate (251) that ‘the effects of joint ownership differ significantly across different IP rights and across different jurisdictions’).

16 By way of example, reference can be made to Minden Pictures, Inc. v. Pearson Education, Inc., No. C 11-05385 WHA (ND Calif. 5 March 2013) in which the court invalidated over 4,000 identical copyright assignment agreements that had purported to grant co-ownership rights because such assignments did not transfer more than the bare right to litigate the copyright, which was not valid (as a result of previous case law: see Silvers v. Sony Pictures Entertainment, Inc., 402 F.3d 881, 896 (9th Cir. 2005)).

17 The explanatory memorandum relating to the Proposal for a Directive, n. 12 above, p. 2, refers to ‘new business models for using co-created knowledge’. 
5.2.3 Dependence from Uses of Innovation by Third Parties (Licensing In/Out)

Open innovation means that companies frequently use intangible assets owned by other market players in their own business activities (particularly of technological solutions protected by IPRs). It is obvious that such users (licensees or sublicensees) rely on their continued ability to use the IPRs owned by third parties on which they depend and which can be put at risk in case of early termination of the license from which they benefit or from bankruptcy proceedings that could be initiated against their licensor. From this perspective, the dependence of licensees and sublicensees is a common phenomenon. What is of relevance and of interest is to note a certain shift of power, which is perceivable in different countries and legal systems, that reflects the acknowledgment of the risks assumed by licensees and sublicensees which therefore call for some additional protection.

This is particularly reflected in two recent German decisions which protected sublicensees in case of termination of the main license. The German Bundesgerichtshof indeed held in two parallel decisions rendered on the same day in July 2012 that a copyright sublicensee could continue to benefit from its right to use the relevant work (a musical work and a software product, respectively) in spite of the termination of the main license.\(^\text{18}\) The important lesson of these cases is that the termination of a main license does not necessarily affect the continuation of a sublicense. This consequently means that even if it validly terminated its license agreement with its licensee, a licensor can still face the risks of having to tolerate the existence of sublicensees (from which he could nevertheless still derive income). This does not appear as a natural and expected result in the light of fundamental principles of private law (particularly of the principles of privity of contract and the relativeness of contractual relationships: *res inter alios acta nec prodest nec nocet*) knowing that a licensor can end up being forced to tolerate (in a quasi-contractual relationship) the use of its IPRs by a third party with which it did not enter into direct contractual relationships. The solution developed by the German courts in these

parallel cases raises a number of complex questions and has unsurprisingly triggered many comments in the legal literature. Viewed from the outside, these decisions are of key importance and trigger many questions: shall these cases also apply to other types of IPRs beyond copyright? Shall a sublicensee be protected only with respect to a use in Germany (in the affirmative, what would happen in case of multiterritorial sublicenses?)? How can the licensor terminate the license with the ex-sublicensee (in one of the two cases – Take 5 – the exclusive license will expire in 2047)? On what legal basis can the royalties unduly paid by the ex-sublicensee to the ex-licensee be reimbursed to the licensor? These issues can become quite complex in an international setting because it will require to define the law that shall govern that (unjust enrichment) claim. Under Rome II, this will be the law governing the former license agreement (now terminated) between the licensor and the ex-licensee (which was ‘[US law]’ in the Take 5 case).

Situations of interdependence can also occur in the classical scenario of bankruptcy of the licensor or of the licensee, as confirmed by recent case law. In a decision of 3 December 2013, the US Court of Appeals for the Fourth Circuit affirmed a decision of the lower court (the United States Bankruptcy Court, ED of Virginia) which held that licensees could continue to benefit from their licenses under US patents that were granted by a foreign licensor (German-based Qimonda AG) over which bankruptcy proceedings had been initiated in Germany. By doing so, the US
court essentially held that the interests of the licensees should prevail over those of the licensor (in other words, the German company holding the patents) thereby recognizing ‘that licensees have a strong interest in maintaining their right to use intellectual property following the licensor’s bankruptcy’\(^{21}\) and that failing to do so would ‘slow the pace of innovation’\(^{22}\) in the United States. The Court noted that, even if the licensor (represented by the administrator of the bankruptcy in Germany) had committed to re-license the patents to the licensee on reasonable and non-discriminatory terms (RAND), this was not sufficient to eliminate the risk of dependence to which the licensees were exposed because it was ‘far from clear whether, having once facilitated the termination of license rights in a foreign insolvency proceeding, the genie could ever be put back into the bottle’.\(^{23}\)

These various decisions confirm that courts feel the need to intervene in order to protect licensees against (foreign) licensors in view of the dependence of the licensees, whereby courts sometimes rely on fundamental legal instruments, such as local public policy, in order to justify their decision. In \textit{In re Qimonda}, the lower court held that not protecting licensees of the US patents in the bankruptcy of the foreign licensor ‘undermine[s] a fundamental [US] public policy promoting technological innovation. For that reason, the court holds that deferring to German law, to the extent it allows cancellation of the US patent licenses, would be manifestly contrary to US public policy’.\(^{24}\) This consequently shows that courts tend to

\(^{21}\) \textit{Jaffe v. Samsung Electrics Co., Ltd}, 737 F.3d 14, 32 (4th Cir. 2013) (which refers to the Senate Report accompanying the Bill that became § 365(n) of the US Bankruptcy Code – which is the provision which grants a specific protection to licensees in case of bankruptcy of the licensor).

\(^{22}\) \textit{Jaffe v. Samsung Electrics Co., Ltd}, 737 F.3d 14, 32 (4th Cir. 2013) (which quotes the expression used by the Bankruptcy Court, 462 B.R. 165, 185 (Bankr. ED Va. 2011)).


\(^{24}\) \textit{In re Qimonda AG}, Case no. 09-14766-SSM, United States Bankruptcy Court, ED of Virginia (28 October 2011), Bankruptcy Court, 462 B.R. 165, 167, it being noted that this finding of a conflict with US public policy was not expressly confirmed on appeal.
actively intervene in order to protect licensees who are confronted with the bankruptcy of their licensor.\textsuperscript{25}

Court decisions rendered in other jurisdictions confirm this trend and show the complexities to find an adequate balance between the respective rights of the parties to an intellectual property contract. The High Court of Justice (Queen’s Bench Division) of England and Wales recently had to decide whether to grant an injunction preventing the termination of a license agreement for which the ex-licensee had applied (pending the resolution of an arbitration which had just been initiated pursuant to the arbitration clause provided for in the license agreement). The licensee claimed that its business activities totally depended on the continuation of the license agreement (which related to the use of an ‘eMarketplace’, in other words, a commercial Internet-based electronic platform) because the termination of the license would ‘permanently destroy’ its business. The court ultimately refused to grant the injunction for the reason that the licensee had failed to show that damages were not an adequate remedy, but still admitted ‘to a degree of unease at the result’.\textsuperscript{26}

In Switzerland, the Swiss Supreme Court recently decided that a long-term contract entered into between graphic designers and a creative agency under which the designers assigned their copyrights in fictional graphical animals that they had created to the agency could not be terminated for just cause by the designers even if the animals had been slightly changed by the final client (a major Swiss food company) of the creative agency.\textsuperscript{27} What is interesting in this case is that the Swiss Supreme Court essentially held that the agreement could not be terminated by the designers because the


\textsuperscript{26} AB v. CD (Rev. 2) [2014] EWHC 1 (QB) (3 January 2014), Stuart-Smith J (in a ‘postscript’ to the decision) para. 43.

final client had made significant investments and should therefore be in a position to continue to use the animals in spite of the minor breaches of the agreement. The Court thus implicitly admitted that the client’s dependence over the use of the copyrighted works created by the designers should be protected.

What can we learn from these decisions? Beyond the complex legal issues that they raise under the relevant applicable laws and even if at least some of the issues could adequately be addressed by contract, these decisions fundamentally illustrate the growing awareness of the dependence which can be generated in intellectual property licensing transactions and which are particularly apparent and complex when these transactions have a transnational scope (as illustrated by the US decision in the Qimonda case).

They also demonstrate that courts increasingly perceive the need to protect licensees (or sublicensees) in certain circumstances, thereby reflecting the concern that licensees may sometimes be extremely (if and perhaps excessively) dependent on the use of the licensed IPRs which are owned by a third party.

5.3 CONCLUSION

In today’s networks of (open) innovation, intellectual property interdependence is pervasive: individual companies can (heavily)
depend on third parties with respect to their use of intellectual property for running their business activities. As discussed above, interdependence can arise in very diverse settings, and particularly between innovation generators (R&D entities) and their clients, between joint creators of innovation and between licensors and licensees (and sublicensees).

As we know, the entire intellectual property system is based on a balance of interests through which the existence and the scope of IPRs should carefully reflect the delicate and evolving balance between the respective interests of the stakeholders (specifically the owners and the users of the rights). Now, it is also important to make sure that this balance is equally reflected in intellectual property licensing transactions. While common wisdom may hold that licensors generally benefit from a privileged position because of the control they exercise over their intellectual assets, so that, as a result, licensees depend on their licensors, the recent case law discussed above suggests that licensees (and even sublicensees) have gained significant power: under certain circumstances, they can continue to benefit from a license or from a sublicense even if such possibility is not granted under the bankruptcy laws of the country where the licensor is based or even if the main license is terminated: licensors can therefore also depend on their licensees or even their sublicensees.

Even if this is obviously good news for the licensees/sublicensees, this should not hide the fact that in a globalized world in which open innovation flourishes, almost every company is (or can quickly become) both a licensor (outbound open innovation) and a licensee (inbound open innovation). It would thus be clearly erroneous and risky for a local regulator or a local court to adopt or promote a legal regime which would tend to protect licensees in view of their dependence. While this may look attractive in the short run, such approach would ultimately affect negatively the ability of the (local) licensees to access and use (foreign) IPRs and their ability to operate as licensors.

What is consequently needed is a system which shall adequately manage the interdependence between the market players, and most particularly between the parties to licensing transactions. Such regime should equitably balance the respective interests of the stakeholders, and as regards licensing transactions, the regime should balance the interests of licensees in continuing to use the
licensed rights and those of the licensors in keeping control over such rights.

In this respect, it is essential to realize that this growing interdependence is not limited to issues of substantive law, such as the regime of intellectual property co-ownership (substantive interdependence): interdependence also materializes in the way in which disputes arise and are solved (procedural interdependence).

As exposed in a recent survey conducted by the WIPO Arbitration and Mediation Center on technology disputes, today’s business transactions are ‘increasingly complex, with the contractual framework often involving multiple parties from different jurisdictions and different types of organizations’, it being further stated that ‘[t]here is a trend away from one off licensing of A to B, and towards multi-party know-how and IP arrangements in the context of bigger projects’ (IP Lawyer, France).31 On this basis, the increased interactions between companies in the generation and use of innovation and of intellectual property assets increase the risks that complex multiparty disputes may arise and that stakeholders may face a situation of procedural interdependence.

Managing the risks of intellectual property interdependence therefore also means ensuring the efficiency of dispute mechanisms. This particularly implies being aware that different proceedings may increasingly need to be coordinated or that the outcome of certain proceedings may be dependent on the outcome of other preliminary proceedings.32 The question therefore arises whether

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32 This scenario is reflected in recent decisions rendered in Switzerland; see, for example, the recent decision of the Federal Patent Court which addressed the procedural issue of the fixing of filing fees for the proceedings (which depends on the determination of the amount in dispute), in which the court acknowledged the existence of previously filed arbitration proceedings in which the amount in dispute was much higher by comparison to the amount which was disclosed before the court; see decision of the Swiss Federal Patent Court of 28 October 2013 (ref. O2013_004); see also judgment of the Swiss Federal Supreme Court of 11 May 2010 (ref. 4A_616/2009) (proceedings based on a violation of Swiss unfair competition law for misappropriation of trade secrets, referring to an arbitration proceeding in which an ICC arbitral tribunal had already decided on a related breach of an obligation of confidentiality).
and how the parties can anticipate such scenarios and adopt – if possible and if felt appropriate – a dispute resolution system which may make it possible for them to solve the entirety of their dispute before one unique dispute resolution body (particularly an arbitral tribunal).

In short, there is a need to conceptualize a framework that shall address these situations of intellectual property interdependence. If this is not done, the risk is that this may hamper the future development of cooperative open innovation networks which characterize our connected network economy.