

MOST FAVOURED-LICENSEE CLAUSES IN LICENCE AGREEMENTS

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This is a continuation of Panagiota Koutsogiannis and François Painchaud's article concerning licence agreements. The authors will now comment on the issue of "best efforts".

The difficulty arising from this type of provision is in defining the term "best effort" and in deciding what type of effort can be considered as the "best" effort. Although this term is widely used in licensing agreements, the uncertainty over legal treatment of such a provision impedes the ability of parties to contract effectively.

Over the years, the courts in the United States and Canada have been called upon on several occasions to interpret "best efforts" clauses. Each time, the courts have been inconsistent in the treatment of such a clause and it is therefore difficult to appreciate the extent of the obligation placed on a licensee (or licensor) who is bound to put forward his best effort in marketing or developing a certain product.

In *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2nd Cir. 1979) the Court was of the opinion that the best efforts obligation was violated even though the sale of the product was highly unprofitable. However, in *Western Geophysical Co. v. Bolt Associates, Inc.*, 584 F.2d 1164 (2nd Cir. 1978), the best efforts obligation was held to be satisfied even though no device had been made or sold. This was due to the fact that the device was not mechanically sound and Western was trying to improve the mechanical reliability of the device before putting it on the market. However the efforts put into developing the product were seen by the Court as being sufficient to satisfy the contractual obligation of using □best efforts□.

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In *Zilg v. Prentice-Hall, Inc.*, 717 F.2d 671, cert. denied, 466 U.S. 938 (2nd Cir. 1983), the test used for deciding whether "best efforts" had been used was limited to whether the product had been given a reasonable chance of achieving market success.

Another test used by the courts in determining whether the obligation of "best efforts" is being satisfied is a subjective test as opposed to an objective one. This test would take into consideration the potentialities of the licensee's business and the circumstances that might arise to affect it. The party with such an obligation can only be asked to do that which is reasonably expected under the circumstances (*Respirex of Canada Ltd. v. Flynn* (1975), 22 C.P.R. (2d) 104 (Ont. H.C.) affirmed (1978) 41 C.P.R. (2d) 74 (Ont. C.A.)).

In Canada, there is case law defining the term "best efforts" used in contracts other than technology transfer agreements. The courts in such cases seem to equate the best efforts provision to an obligation to "leave no stone unturned": *C.A.E. Industries Ltd. v. R.* (1983), 2 F.C. 616 (F.C.T.D.). This would impose a tremendous obligation upon the licensee to ensure that every single possibility for exploiting or efficiently marketing the product has been thought of and that no angle has been neglected. Such an obligation would imply a substantially greater effort to be given by the licensee than that which is usually required to satisfy this type of obligation by the American courts.

Implied Obligation of Best Efforts

The courts have sometimes had to decide whether, in the absence of an express obligation to that effect in a contract, the licensee is bound to the performance of "best efforts" arising from an implied obligation. This issue was dealt with in detail by the U.S. Court of Appeals in *Permanence Corporation v. Kennametal, Inc.*, 908 F.2d 98 (6th Cir. 1990). The Court acknowledged that such an obligation has sometimes been inferred in certain circumstances where for example "no advance payments were made and the licensor had to rely entirely on the good faith of the licensee in order to receive any consideration in return for the grant of the exclusive agency."

The argument of the licensor in this case was that the provision for royalty payments implies a best efforts obligation because royalties will only be generated if the defendant is under a duty to exploit the patented process. However the Court came to the conclusion that a substantial minimum or advance royalty payment provides sufficient incentive and demonstration of good faith by the licensee to devote best efforts for the development of the technology, and that the implication of a best efforts obligation need not be made. In addition, the Court stated: "Especially, as is true in the present case,

when an inventor grants a licence to patented technology, the application of which is unknown, a commitment on the part of the licensee to devote best efforts to the development of the technology is a substantial commitment which should not be automatically inferred".

In light of this, it would seem that a licensor or licensee who wishes to obtain an obligation of best efforts from the other party should make sure to include an express obligation to this effect in the agreement itself.

Alternatives to the "Best Efforts" Clause

The following are alternatives to the "best efforts" clause: i) the priority of developing the licensed product can be stated in relation to other products and technologies that are being developed at the time of formation of the contract; ii) the priority of the new product to be developed could be stated relative to the product lines of the company in terms of per item profit, sales volume, historical importance to the company etc; iii) the limitations of the budget and workforce of the company could be stated as limitations on a "best efforts" obligation; iv) minimum and maximum commitments of manhours and expenses could be detailed; and v) work to be performed could be outlined in some detail, etc.

It is therefore preferable to specify minimum performance requirements rather than broad, vague terms such as "best efforts" or "reasonable efforts".

In conclusion, it is important to note that using a standard model may be helpful but may not always be suitable for all clients who have different needs and objectives. It is essential to read each clause and carefully adapt it to the particular case in question in order to provide the client with a licensing agreement suitable for his or her needs.

