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Licensing Tips

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Defining Affiliate: Pay Attention to the “Boilerplate”

When licensing a patent, software, copyrightable work, or other intellectual property, it's common to license the property to a particular entity and its “affiliates.” When defining the term “affiliates,” many license agreements use a “boilerplate” definition that was taken from a previous agreement or form document. But are the parties always sure that the definition includes all parties that they actually intend to include? Does the licensee always benefit from a broad definition, and the licensor always benefit from a narrow one?

Perhaps not. This is because at least two district court decisions recently held that a licensee’s “affiliates” are limited to those affiliates that were in existence on the effective date of the license agreement, unless the agreement explicitly states otherwise.

In the first case, *nQueue Inc. v. Control Systems (USA) Inc.* [No. CV-12-01365, (C.D. Ca. Nov. 27, 2013)] nQueue Inc. filed a patent infringement suit against Control Systems (USA) Inc. In defense, Control Systems argued that it was covered by a perpetual license that nQueue granted to Control Systems’ ultimate parent company, Equitrac Corporation, in an agreement dated July 19, 2012.

Although the agreement granted the license to Equitrac and its “Affiliates,” the agreement defined “Affiliate” as any entity “that controls, or is controlled by, or is under

common control with that Party (either directly or indirectly) *as of the Effective Date of the Agreement*” (emphasis added). Equitrac acquired Control Systems after the effective date, so the court held that Control Systems was not covered by the license.

The second case, *Ellington v. EMI Music, Inc.* [2014 N.Y. Slip Op. 7197, (N.Y. Ct. App. Oct. 23, 2014)], involved the terms of a royalty provision found in a 1961 copyright renewal agreement between the legendary musician Duke Ellington and a group of music publishers, including the predecessor to EMI Music. The royalty provision established a revenue sharing arrangement under which Ellington (and his heirs) were entitled to 50 percent of net revenues resulting from sales by EMI and its affiliates.

The dispute arose after EMI granted sublicenses to several newly-created, affiliated entities, and EMI paid the Ellington heirs 50 percent of the net revenue that it received from these affiliated sublicensees. However, because the entities were affiliates of EMI, Ellington’s heirs argued that they were entitled to 50 percent of the *affiliated sublicensees’* net revenues, not just a share of what EMI received from the affiliated sublicensees.

The court disagreed with the Ellington heirs’ argument, noting that the agreement contained no forward-looking language:

Absent explicit language demonstrating the parties’ intent to bind future affiliates

of the contracting parties, the term “affiliate” includes only those affiliates in existence at the time that the contract was executed.

The *Ellington* case shows that the licensor-heirs could have benefitted from a broad definition, because a broader definition would have brought a larger number of entities into a higher-level royalty obligation.

The two cases illustrate that the parties should carefully consider each clause of the license agreement. This includes definitions that could be considered “boilerplate” in many situations. Often, the licensor is the entity that seeks to narrowly define the licensed entities, and the *Control Systems* case illustrates how a narrow definition of “Affiliate” benefitted the licensor. However, the *Ellington* case shows that a licensor can benefit from a *broader* definition if the definition brings more entities into a more lucrative royalty structure.

Because of this, each party should carefully review the definition of “affiliate” before signing a license agreement. Examples of issues that a licensor may consider include:

- If the licensee receives favorable financial terms (such as lower royalties—or no royalties—in exchange for a lump sum payment), if the licensor wants flexibility to negotiate other licenses on a case-by-case basis, or if the licensor simply wants to retain a greater level of control over who may use its intellectual property, then the licensor should seek a narrow definition of “affiliate.”
- If the financial terms favor the licensor, or if the licensor wants to provide flexibility to bring more entities under the

scope of the license, then a broader definition may be better for the licensor.

Either way, it's important to carefully study the "boilerplate"

of a proposed agreement to ensure that it matches the parties' intended business goals.

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