

PUBLIC POLICY AND THE ARBITRABILITY OF INTELLECTUAL PROPERTY DISPUTES

By Greg Wood

I. Introduction

Arbitration offers many advantages in addressing and resolving disputes, specifically intellectual property disputes. Among these advantages are party control (the parties retain control of the process and issues to be decided to a greater degree than if the matter was submitted to the courts),¹ certainty of forum (the risks of inconsistent results can be avoided where intellectual property disputes implicate the laws and procedures of multiple countries),² speed (arbitration can be faster since it is not hostage to court dockets and calendars),³ control of arbitrator selection (the parties can select arbitrators with particular expertise),⁴ flexibility (in process and substance),⁵ privacy and confidentiality (there is greater likelihood that a business relationship can be preserved or restored),⁶ enforceability (awards in New York Convention⁷ signatory nations are enforceable in all other signatory nations),⁸ lower costs⁹, and a greater likelihood of finality (arbitration decisions are rarely appealable),¹⁰ to name just a few.¹¹

There is nevertheless a perceived reluctance to choose arbitration for intellectual property disputes. Reasons for this that are often cited include: (1) the desire to retain the possibility of invoking legal strategies and appeals in “bet the company” intellectual property disputes; (2) a need to keep the availability of publicity as a means of effecting investor

¹ David D. Caron, *The World of Intellectual Property and the Decision to Arbitrate*, Arbitration International, Vol. 19, No. 4 at 441 (2003).

² Philip J. McConnaughay, *ADR of Intellectual Property Disputes*, at 2, <http://euro.ecom.cmu.edu/program/law/08-732/Courts/ADRPMcCon.pdf>

³ *Id.* at 3.

⁴ *Id.* at 4.

⁵ *Id.* at 5.

⁶ *Id.* at 4.

⁷ See, 9 U.S.C. Sections 201-208 (1996) and 9 U.S.C. Sections 1-16 (1996)

⁸ McConnaughay, *supra* note 2, at 6.

⁹ Alejandro Garcia, Sophie Lamb, *Arbitration of Intellectual Property Disputes*, The European & Middle Eastern Arbitration Review 2008, Section 3.

¹⁰ *Id.*

¹¹ David Allgeyer, *In Search of Lower Cost Resolution: Using Arbitration to Resolve Patent Disputes*, Conflict Management, Fall 2007, Volume 12, Issue 1.

perceptions; (3) a preference to retain flexibility in modifying and adapting claims as the case proceeds; (4) the desire to keep disputes in familiar forums where procedures and relationships are known; and (5) concerns that intellectual property disputes might not be arbitrable or that intellectual property arbitration awards would not be enforced such as on public policy grounds.¹² The concern related to arbitrability and public policy in intellectual property disputes merit a closer analysis. Patent, trademarks, and copyrights, and to a lesser extent trade secrets, are specially vested with a public interest because the rights are creations of the state given to individuals for the broader common or public goods. Arguably then, the state which defined the nature and scope of intellectual property rights granted to an individual should retain control over enforcement to ensure that the public interest is protected. Obviously, this raises issues of the enforceability of the agreement to arbitrate and the enforcement of an arbitration award.¹³

II. Arbitrability of Intellectual Property Disputes

The question of arbitrability begins with whether the parties have agreed to arbitrate their intellectual property dispute. Such an agreement can be reached after a dispute arises but more often arises from an arbitration clause in a pre-dispute license or commercial agreement.¹⁴ However, the agreement to arbitrate does not necessarily render a dispute arbitrable or an award enforceable. Section 2 of the Federal Arbitration Act, provides that an agreement to arbitrate is enforceable “...save upon such grounds as exist at law or in equity for the revocation of any contract”¹⁵ and Section 12 (4)¹⁶ provides that an award may be vacated “[w]here the arbitrators exceeded their powers...” Accordingly, an agreement to arbitrate an intellectual property dispute that is procured by fraud, is unconscionable, or where arbitration is precluded by a specific statute, could be challenged. Nevertheless, public policy embodied in the Federal Arbitration Act strongly favors arbitration.¹⁷ This policy favoring arbitration was extended to patents in 1982 with the amendment to the patent statute that explicitly approved arbitration of

¹² Caron, *supra* note 1, at 442, 445-448.

¹³ David W. Plant, *Resolving International Intellectual Property Disputes*, 30-31 (1999)

¹⁴ Daniel Schimmel and Ila Kapoor, *Resolving International Intellectual Property Disputes in Arbitration*, *Intellectual Property & Technology Law Journal*, February 2009.

¹⁵ 9 U.S.C. § 2.

¹⁶ 9 U.S.C. § 10(4).

¹⁷ 9 U.S.C. § 2.

patent disputes¹⁸ and has been recognized as a means of resolving trademark and copyright disputes¹⁹ notwithstanding that arbitration is a private resolution affecting intellectual property rights granted to individuals for the broader public interest. This seeming surrender of control over enforcement of intellectual property rights to individuals in arbitration is rationalized on the grounds that such arbitration awards bind only the parties involved and only minimally impact the public at large.²⁰ Consequently, the arbitrability of intellectual property disputes has become a historical and academic exercise rather than a present impediment to arbitration at least in the United States. As such, intellectual property issues such as validity, enforceability, ownership, infringement, and claim interpretation are issues subject to resolution in arbitration. That does not mean that the arbitrator might not find that a patent was invalid for failing to meet statutory requirements or that a license was invalid because it violated statutory prohibitions or was contrary to public policy such as extending the requirement to pay a royalty beyond the statutory expiration of the patent, but the dispute itself would nevertheless be arbitrable.²¹

By contrast, intellectual property disputes may not be arbitrable in the international arena. The New York Convention²² provides that:

V. (2) Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

- a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or*
- b) The recognition or enforcement of the award would be contrary to the public policy of that country.*²³

Accordingly, in a country where the validity of a patent issued by that country is required to be determined by its courts, patent validity would not be arbitrable. One illustration of this is South Africa whose laws give exclusive jurisdiction to hear and decide patent infringement and validity issues to the “commissioner.”²⁴ This is presumably based on the notion that disputes

¹⁸ 35 U.S.C.A. § 294.

¹⁹ See 1 Domke on Com. Arb. § 16.12.

²⁰ See 35 U.S.C. § 294.

²¹ See *Mitsubishi v. Soler Chrysler-Plymouth*, 473 U.S. 614, 628-629 (1985).

²² The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, T.I.A.A. No. 6997, 330 U.N.T.S. 38.

²³ The New York Convention is enforceable in the United States under 9 U.S.C. §201 et seq.

²⁴ China, Singapore and Romania also limit arbitrability of patent disputes. Schimmel, *supra* note 14, at 3.

that might affect the public should be decided by the patent commissioner and not by a private arbitrator.²⁵ However, suppose that the arbitration venue was the U.S. not South Africa and the same issues of infringement and validity of the South African patent were raised in arbitration? Section V (2) (a) of the New York Convention only permits the “competent authority” of the country where recognition or enforcement is sought or to deny arbitrability. Consequently, if the parties had set the arbitration venue to be the United States and the issue to be arbitrated was infringement of a South African patent, the arbitrator in the US would be bound by U.S. law not the law of South Africa and therefore should decide the infringement issue as between the parties to the arbitration under Section 2 of the F.A.A. Suppose that the award of the U.S. arbitrator was then presented to a South African court for enforcement. A denial of enforcement of the award in South Africa would be permitted under either Section V (2) (a) or (b) of the New York Convention. If the award was presented for enforcement in another convention country, that country would be compelled under Article III of the New York Convention to enforce the award notwithstanding South Africa’s prohibitions.

Finally, suppose that South African law or public policy prohibited enforcement an arbitration infringement award even as to foreign patents, then a court in South Africa could deny enforcement of an award rendered in a U.S. arbitration related to a U.S. patent. These examples demonstrate that it is the laws and courts in the country where recognition or enforcement is to take place that will control subject to the impact of a choice of law clause in the arbitration agreement.

Therefore, on the issue of arbitrability, intellectual property disputes can raise statutory or public policy issues that could preclude an arbitrator from deciding a particular intellectual property issue in the first instance. However, such arbitrability issues will primarily arise in international arbitration under the New York Convention rather than in domestic arbitrations pursuant to state and federal arbitration laws. If there is an arbitrability issue, it should be raised at the outset of the arbitration and would be decided by the court²⁶ in a separate proceeding unless the parties had agreed otherwise.

The arbitrability challenge can therefore be said to arise either from the limitation in the arbitration agreement itself where one of the parties denies an agreement to arbitrate in the first

²⁵ Garcia, *supra* note 9, at 3.

²⁶ 9 U.S.C. § 4.

instance or from the laws of the jurisdiction where the arbitration takes place that prohibit use of arbitration to resolve the dispute at hand. Accordingly, care should be taken in crafting an arbitration agreement to select an arbitration forum where arbitration of intellectual property disputes is permitted and that the risks of other challenges to arbitrability are minimized.

However, arbitrability is only part of the issue. Another challenge, briefly alluded to above, is enforceability of an award. Again, non-enforceability can arise from a number of grounds. However, the one to be discuss hereafter is the challenge that an award is unenforceable because it violates the public policy of the enforcing state under Section V (2) (b) of the New York Convention.

III. Public Policy’s Challenge to Enforceability of Arbitration Awards.

Article III of the New York Convention requires that each contracting state “shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon.”²⁷ When a state becomes a contacting party to the New York Convention, it effectively adopts this recognition and enforcement obligation as its “public policy.”²⁸ Nevertheless, Article V (2) (b) of the New York Convention sets out an exception to this strong public policy of recognition and enforcement: That such recognition or enforcement would be “contrary to the public policy of that country.” This exception is in the first instance somewhat anomalous. By becoming a signatory to the Convention, the contracting country in effect adopts as its public policy the recognition and enforcement of arbitration awards. Therefore, not enforcing such an award on public policy grounds would seem to be a violation of the very public policy of recognition and enforcement that the contracting country adopted by becoming a member of the Convention. Consequently, Article V (2) (b) would seem to refer to a more significant “public policy” that would trump the recognition and enforcement public policy of the contracting state.

²⁷ New York Convention Article III. See also 9 U.S.C. § 2.

²⁸ Winnie (Jo-Mei) Ma, *Public Policy in the Judicial Enforcement of Arbitral Awards: Lessons For and From Australia*, Bond University Degree of Doctor of Legal Science (SJD) Thesis 109 (2005), citing David Branson, ‘USA’ in Global Legal Group, *International Comparative Legal Guide to International Arbitration 2004* (2004) 241, 245.

A second observation regarding the public policy exception is that it is the authority in the country where enforcement is sought that makes the determination. Thus, if recognition and enforcement of an arbitration award rendered in Country A was sought in Country B, Country B would decide whether recognition and enforcement was to be denied on public policy grounds.

A third observation is that it is the public policy of the recognizing and enforcing country that controls the determination. Thus, in the example given above, Country B would not only decide whether to recognize and enforce the award but it would do so *based on its own public policy* not the public policy of Country A or any other country.²⁹

A final observation relates to the discretionary nature of Article V. Thus, the contracting state in which recognition and enforcement of an award is sought is not compelled to refuse recognition and enforcement even when it could do so based on public policy grounds under Article V(2)(b). Thus, the enforcing courts retain discretion to enforce an award even if one of the parties or the courts finds that Article V (2) (b) would justify an exception to enforcement.³⁰

Other implicit limitations on the application of the public policy exception have also been suggested including that the exception is confined to public policies that are applicable at the time of the enforcement proceedings; confined to the enforcement of a state's public policies applicable to transactions involving foreign elements; and confined to enforcement of a state's fundamental public policies.³¹ However, rather than identifying the *source* of the public policy, the adjudicating authority, or the scope of discretion of the adjudicating authority, these implicit limitations seem to refer to the *definition of the public policy itself*. So the question is raised: What is "Public Policy" under the New York Convention?

In order to understand the meaning of "public policy" referred to in the exception to enforcement and recognition in Article V (2) (b), it is important to distinguish between "public policy," "international public policy" and "transnational public policy."³² One author defines "public policy" as those "moral, social or economic considerations which are applied by courts as grounds for refusing enforcement of an arbitral award"³³ and the "principle of law which holds that no subject can lawfully do that which has a tendency to be injurious to the public, or

²⁹ *Id.* at 59-60.

³⁰ *Id.* at 144.

³¹ *Id.*

³² Audley Sheppard, *Public Policy and the Enforcement of Arbitral Awards: Should there be a Global Standard?*, *Transnational Dispute Management*, Vol. I, Issue 01 (February 2004).

³³ *Id.*

against public good.”³⁴ By contrast, “international public policy” has been described as “that public policy which is applied by State courts to foreign awards rather than domestic awards.”³⁵ In other words, “international public policy” is the public policy that the enforcing country would deem applicable to international awards. Finally, “transnational public policy” has been defined as consisting of those principles representing an “international consensus as to universal standards and accepted norms of conduct that must always apply.”³⁶ Thus, “transnational public policy” would encompass the principles of universal justice and morality accepted by civilized nations.³⁷ Stated more simply, “public policy” pertains to the public policy of one nation regarding its internal affairs, “international public policy” pertains to those policies perceived by one state as being consistent with the policies of a group of nations and “transnational policy” pertains to the policy shared by the international community as a whole.³⁸

Public policy can also be categorized as substantive and procedural. Substantive public policy refers to the substance of the arbitrable award including the factual and legal bases for the award. Thus, taking an extreme example, an arbitration award for breach of a contract related to human slave trade would be denied enforceability because slave trade would be against substantive public policy. Similarly, an award might be denied enforceability if a party against whom the award was granted was not given notice or an opportunity to defend because the award was in violation of public policy that accords procedural due process.

So which of these definitions applies to the New York Convention public policy exception? Reference to the Drafting Committee of the New York Convention, the 1927 Geneva Convention, the 1975 Panama Convention, the 1983 Riyadh Convention, and the 1987 Amman Convention yield different understandings and applications of the public policy exception ranging from broad to narrow. However, the preference is for the public policy exception to be narrowly applied.³⁹ Thus, enforcement of an arbitration award should be denied on public policy grounds “only where enforcement would violate the forum state’s most basic notions of

³⁴ *Egerton v. Brownlow*, 4 HLC 1 (1853).

³⁵ Sheppard, *supra* note 32, at 2.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

morality and justice.”⁴⁰ Applying this perception of public policy, a court in the U.S. should enforce an arbitration award under the New York Convention even though a similar claim would have been precluded had it arisen in a U.S. domestic transaction.⁴¹

While much has been written on the topic of the public policy exception and courts in New York Convention countries have reached different conclusions as to whether the public policy exception to recognition and enforcement should be broad or narrow, several conclusions seem warranted. First, the recognition and enforcement of arbitration awards should only be denied on public policy grounds in the most exceptional of cases. Second, the public policy defense should not be “a parochial device protective of national political interests...”⁴² The internal public policy applied by a state to govern its own internal affairs should not be a basis for denying enforcement of an award considering the policy accepted by all contracting states to accept and enforce arbitration awards from other New York Convention states. Third, the enforcing state should only reassess underlying facts upon which an award was based only when there is a strong prima facie case that international public policy has been violated.⁴³

IV. Public Policy and the Enforcement of Awards Related to Intellectual Property Matter.

Having seen that disputes related to intellectual property rights are arbitrable and that an award may be denied enforceability if contrary to the forum state’s public policy – its most basic notions of generally accepted morality and justice, we next examine examples of public policies that defined the parameters of intellectual patent rights in the United States.

A first example arises from the Supreme Court case of *Lear v. Adkins*. In that case, the doctrine of licensee estoppel was considered and abrogated on public policy grounds. The specific issue was whether a clause in a patent license precluding a licensee from challenging the validity of the licensed patent was a violation of public policy. On the one hand was the interest of states in enforcing contracts and on the other was the “strong federal policy favoring

⁴⁰ *Parsons & Whittemore Overseas Co., Inc. v. Societe Generale de l’Industrie du Papier RAKTA and Bank of America*, 508 F.2d 969 (2nd Cir. 1974).

⁴¹ Sheppard, *supra* note 32, at 6 citing *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974).

⁴² *Ma*, *supra* note 28, at 65.

⁴³ Sheppard, *supra* note 32, at 6; *Ma*, *supra* note 28, at 63-68.

free competition in ideas which do not merit patent protection.”⁴⁴ After a lengthy exposition of the issues, the court concluded that the right of two contracting parties

*“...do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor’s discovery. If they are muzzled, the public may continually be required to pay tribute to would be monopolist without need or justification. We think it plain that the technical requirements of contract doctrine must give way before the demand of public interest ...”*⁴⁵

Therefore, in the U.S. the strong public policy precludes a licensor from requiring a licensee to forego the right to challenge the validity of the patent as a condition of receiving the license.⁴⁶ But is this public policy a “parochial devise protective of national political interests” or is it in the nature of “international public policy” that while national in focus nonetheless is recognized as embodying a broader internationally recognized policy? In *Lasercomb America, Inc. v. Reynolds*, the court answers this question by setting out not only the origins but the rationale of patent and copyright laws from the sixteenth century in England. This same rationale was the motivation for inclusion of the power to grant patents embedded in the U.S. Constitution.⁴⁷ Consequently, the policy of permitting licensee’s to challenge the validity of licensed patents and copyrights notwithstanding a contract prohibition from doing so is more than just a “parochial devise” but addresses a core value shared by other nations – protecting competition by precluding parties by contract from extracting that which should belong to the public.

Before touching on other public policies that infuse intellectual property interest, examining an illustration of how this particular public policy might impact the recognition and enforcement of arbitration awards. Suppose two parties enter a technology license for an invention covered by patents issued by five different countries, one being the U.S. The license prohibits the licensee from challenging the validity of any of the patents and requires that the licensee continue to pay royalties for five years after the last of the five patents expire. The

⁴⁴ *Lear, Inc. v. Adkins*, 395 U.S. 653, 656, 89 S.Ct. 1902, 1904 (1969).

⁴⁵ *Id.* at 670.

⁴⁶ This policy against licensee estoppel yields to the strong public policy of upholding judgment and settlement agreements so that a settlement agreement that includes a covenant not to challenge validity of a patent in the future will be upheld since the defendant has been given the opportunity to challenge the patent and has given up that right. See *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1369 (Fed.Cir. 2001).

⁴⁷ *Lasercomb America, Inc. v. Reynolds*, 911 F.2d 970, 974-975 (4th Cir. 1990).

license agreement also includes an arbitration clause requiring any arbitration to take place in Country A pursuant to the laws of Country A. Arbitration is thereafter initiated in Country A. The arbitrator, following the terms of the agreement, declines to hear any challenge to the validity of the U.S. patent and enforces the contractual obligation to pay royalties after the expiration of the five patents including the U.S. patent. The licensor seeks to have a court in the U.S. enforce the arbitration award relying on Article III of the New York Convention and Section 2 of the Federal Arbitration Act. The licensee seeks to have the award vacated or otherwise not enforced asserting that the award is contrary to U.S. public policy both because challenges to validity by a licensee must be permitted and because requiring payment of royalties after a patent expires expands the scope of a patent beyond that granted by the US patent office.⁴⁸

Would the U.S. court decline to enforce an award under Article V (2) (b)? In the first instance, the public policy in issue is that of the United States. Second, as above noted, this U.S. public policy permitting challenges to patent validity and allowing challenges based on misuse (which actually arises out of antitrust principles) is not simply a parochial device but is in the nature of a national public policy arising out of values and mores held by other countries as well. Accordingly, a court in the U.S. would have the authority to refuse to recognize or enforce the award at least as to the U.S. patent.

Modifying the illustration somewhat, suppose that enforcement of the award in Country B (not the U.S.) was sought. None of the patents were issued by Country B and Country B has no public policy that it must recognize the patents or public policy of another country. However, Country B is bound to follow its recognition and enforcement obligations under Article III of the New York Convention. In this case, since Country B has no public policy of its own that could be invoked to preclude enforcement and is bound by Article III, it should enforce the award and allow assets of the licensee in Country B to be seized to pay that award. Obviously, the arbitration agreement itself and the selection of the arbitration and enforcement forums become critical strategy concerns.

This particular public policy related to intellectual property is not alone. Other intellectual property related public policies include (1) the prohibition against using a patent or

⁴⁸ *Id.* at 975-977

copyright to secure exclusive rights not granted by the patent or copyright office;⁴⁹ (2) conditioning the grant of a license on the requirement to use or decline to use an unpatented device;⁵⁰ (3) the prohibition against removing the inventions from the public after prolonged public use by the inventor;⁵¹ (4) the policy of prompt and widespread disclosure of new inventions to the public;⁵² (5) the policy of preventing an inventor from commercially exploiting his invention beyond the term of the patent,⁵³ and (6) the policy of allowing an inventor a reasonable time following sales activity to prove the value of the invention before being required to seek patent protection.⁵⁴ These public policies may well also provide a basis for a U.S. Court to refuse enforcement of a foreign arbitration award.

V. Conclusion

Whether the violation of one of these policies will be a basis for a court to decline to recognize or enforce an arbitration award in the U.S. will be subject to the facts and the discretion of the Court. In other countries, similar public policies circumscribing the enforcement of patents may provide the violation of “public policy” under Article V (2) (b) that could render an award unenforceable in one or more countries. The need to examine the laws of each country in which an award is to be sought to ensure that the dispute is arbitrable and to further examine the laws of the country in which an award is to be enforced at the time the arbitration clause is drafted and at the time arbitration is being initiated is obviously of critical importance.

⁴⁹ *Id.* at 977.

⁵⁰ *Id.* at 978.

⁵¹ *General Electric Co. v. United States et al.*, 654 F.2d 55, 61 (Ct.Cl. 1981).

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*