No. B161549

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT DIVISION TWO

CITY OF HOPE NATIONAL MEDICAL CENTER,

Plaintiff and Respondent,

v.

GENENTECH, INC.,

Defendant and Appellant.

Appeal from Judgment Of The Superior Court
For The County Of Los Angeles (No. BC 215152)
(Hon. Edward Kakita (Ret.), Sitting By Assignment)

APPLICATION OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, CALIFORNIA CHAMBER OF COMMERCE, TECHNET, INTEL CORPORATION, AND XILINX, INC. FOR PERMISSION TO FILE BRIEF OF AMICI CURIAE AND BRIEF OF AMICI CURIAE SUPPORTING THE APPELLANT

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APPLICATION OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, CALIFORNIA CHAMBER OF COMMERCE, TECHNET, INTEL CORPORATION, AND XILINX, INC. FOR PERMISSION TO FILE BRIEF OF *AMICI CURIAE* SUPPORTING THE APPELLANT

The Chamber of Commerce of the United States, California Chamber of Commerce, Technet, Intel Corporation, and Xilinx, Inc. respectfully apply for permission to file the attached brief of *amici curiae* in support of the appellant.

The **Chamber of Commerce of the United States** is the world's largest business federation. It represents an underlying membership of more than three million businesses, state and local chambers of commerce, and organizations of every size and in every sector and geographic region of the country. The Chamber has thousands of members in California, and thousands more conduct substantial business in the State. For that reason, the Chamber and its members have a significant interest in the administration of civil justice in the California courts. The Chamber routinely advocates the interests of the national business community in courts and before lawmakers across the Nation. See generally http://www.uschamber.com.

The **California Chamber of Commerce** is a nonprofit corporation, founded over a century ago, that represents more than 14,000 companies of all types and sizes. Its members employ one-fourth of the state's private-sector workforce. The California Chamber represents the interests of businesses before lawmakers and frequently participates as an amicus curiae in cases affecting business interests in the California courts. The California Chamber is a member of the Chamber of Commerce of the United States. See generally http://calchamber.com/about_us/about.htm.

TechNet is a bipartisan network of more than 150 chief executive officers and senior partners of companies in the fields of information technology, biotechnology, venture capital, investment banking, and law. TechNet strives to promote the growth of technology industries and of the economy by building long-term relationships between technology leaders and policymakers. See generally http://www.technet.org/who/index.html.

Intel Corporation, headquartered in Santa Clara, California, is both a leading licensor and licensee of intellectual property. For 35 years, Intel has developed technology enabling the computer and Internet revolution that has changed the world. Since its inception, Intel has invested significant resources in the research and development of innovative intellectual property. Consistent with its industry leadership, Intel has been a party to numerous commercial agreements involving intellectual property. Intel has frequently participated as an *amicus curiae* in intellectual property cases. See generally http://www.intel.com.

Xilinx, Inc., headquartered in San Jose, California, leads one of the fastest growing segments of the semiconductor industry—programmable logic devices. Xilinx develops, manufactures, and markets a broad line of advanced integrated circuits, software design tools and intellectual property. Because its business focuses on the creation and development of intellectual property, Xilinx is a party to many commercial agreements involving intellectual property rights. See generally http://www.xilinx.com.

The proposed brief of *amici curiae* addresses the tort liability that was superimposed on the contractual dispute in this case. The punitive damages element of the judgment rests on the erroneous proposition that a fiduciary relationship arises whenever one party agrees to develop and commercialize another's intellectual property ("IP") and to pay royalties.

Each *amicus* has a significant interest in this issue. The three organizations represent owners, licensors and licensees of IP. The two companies own and license IP, and are parties to many agreements calling for the payment of royalties in exchange for the use of IP rights. Because commercial agreements for the use of IP have become central to the high-technology economy, the *amici* share a strong interest in ensuring that the IP licensing system continues to contribute to commercial stability, innovation, and economic growth.

The proposed brief explains why the intrusion of tort principles and remedies into this contract dispute violates precedent and sound policy alike. The proposed brief examines the reasoning of California Supreme Court decisions that have kept tort remedies out of contract disputes and explains why the same policies should apply to agreements to use IP. The proposed brief further explains why fiduciary duties cannot properly be invoked to inject punitive damages into a commercial contract dispute over royalties. In particular, the proposed brief demonstrates that agreements to develop and pay royalties for IP do not create fiduciary relationships under the governing principles enunciated by the California Supreme Court and this Court. Throughout the proposed brief, the *amici* explain the deleterious consequences of expanding fiduciary duties and tort remedies to encompass commercial contracts to use IP.

Routinely imposing fiduciary duties on parties that purchase or license IP would severely impede the formation and operation of IP agreements—especially agreements to sponsor innovative research in exchange for the resulting IP. Categorical fiduciary duties arose to protect parties in particularly vulnerable positions from exploitation, and properly are confined to a few well-established legal relationships that involve vulnerability and trust that far exceed those present in a business agreement. A contract to develop and commercialize IP is not, and should not be, among the few business relations that produce tort duties as a matter of course. Businesses should not become trustees whenever they buy or license IP in exchange for royalties.

All California businesses, even those that do not regularly engage in IP licensing, have a stake in seeing that California law maintains a clear distinction between contract and tort damages—a distinction significantly eroded by the judgment rendered below. If this Court permits one class of commercial contracts to be characterized as fiduciary rather than arm's-length, other courts may be expected to produce rationales for including other types of contracts within the reach of tort duties and tort damages, undermining the efficient separation of tort and contract law that the California Supreme Court has enforced for many years. This Court should limit the intrusion of fiduciary duties into arm's-length relationships, and of tort remedies into contract disputes.

CONCLUSION

The application for permission to file brief of amici curiae should be granted and the brief filed.

Dated: December 19, 2003

Respectfully submitted.

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INTEREST OF THE *AMICI CURIAE*

The interest of the *amici* is fully described in the Application for Permission, *ante*. The **Chamber of Commerce of the United States** is the world's largest business federation. The **California Chamber of Commerce** represents more than 14,000 companies that employ one-fourth of the state's private-sector workforce. **TechNet** is a bipartisan network of more than 150 chief executive officers and senior partners of companies in the fields of information technology, biotechnology, venture capital, investment banking, and law. **Intel Corporation,** headquartered in Santa Clara, California, develops technology enabling the computer and Internet revolution that has changed the world. **Xilinx, Inc.**, headquartered in San Jose, California, develops, manufactures, and markets a broad line of advanced integrated circuits, software design tools, and intellectual property.

Each *amicus* has a significant interest in the question whether an agreement to develop (and pay royalties for) intellectual property ("IP") creates a fiduciary relationship, so that a breach of the agreement potentially may result in punitive damages. The three organizations represent owners, licensors and licensees of IP. The two companies own and license IP, and are parties to many agreements calling for the payment of royalties in exchange for the use of IP rights. Because commercial agreements for the use of IP are of paramount importance to the high-technology economy, the *amici* share a strong interest in ensuring that the IP licensing system continues to contribute to commercial stability, innovation, and economic growth. The *amici* urge this Court to limit the intrusion of fiduciary duties into arm's-length relationships, and of tort remedies into contract disputes.

INTRODUCTION

The intellectual property dispute in this case has no business masquerading as a tort, much less one worth hundreds of million dollars in punitive damages. Our Supreme Court has repeatedly turned back efforts to transform contract disputes into torts (aside from some disputes involving insurers). Yet a dispute over an agreement by one sophisticated party to pay royalties for another's intellectual property somehow produced tort liability and $200 million in punitive damages—on the startling premise that the royalty agreement rendered one business the *trustee* of the other.

The tort judgment contravenes principles that the Supreme Court has invoked repeatedly in rejecting tort remedies for breaches of noninsurance contracts. The Court has made clear that the "tortification" of contract law

- ignores important differences between the objectives of contract and tort law;
- overrides the finely balanced allocations of risks and rewards that private parties have negotiated in their contracts;
- deprives commercial dealings of stability and predictability;
- spawns needless litigation; and
- requires courts to assume a quasi-legislative role that they are ill-suited to perform.

Despite that clear message, in this case tort law intruded into contract under the label of fiduciary duties. California law, however, confines fiduciary *duties* to a narrow and familiar class of fiduciary *relationships* in which one party necessarily must place a heightened trust in another. By contrast, the reliance that every contracting party places on the other's performance does not make one party into the other's keeper, subject to fiduciary duties and to tort remedies that include massive punitive damages.

The jury in this case was instructed that a novel *per se* fiduciary relationship arose whenever one party "entrusted" its "secret" IP to another in exchange for royalties. But the Supreme Court held years ago that no confidential relationship—much less a full fiduciary relationship—arises from the transmission of "secret" IP through arm's-length negotiation. *Davies v. Krasna* (1975) 14 Cal.3d 502, 510-511.

Indeed, one can scarcely imagine a worse fit for fiduciary duties. Few areas of business require more transactional fluidity than the exchange of IP, a trade that permits innovations to find their most efficient and most socially beneficial uses. Few legal doctrines constrain the free flow of commerce more completely than fiduciary duties, which treat one fully competent commercial actor as the helpless ward of another, and substitute the rarefied, protective atmosphere of fiduciary relationships governed by tort law for the arm's-length, private ordering of affairs by contract.

In an economy increasingly driven by the development and sale of intellectual property, grave consequences attend the insertion of fiduciary duties (and thus the wild card of punitive damages) into the otherwise predictable contractual relationship between the original owners of intellectual property ("IP owners") and those who use the property under a license, assignment, or similar arrangement ("IP users"). Intellectual property agreements ("IP agreements") encompass a wide variety of contractual arrangements in which an IP user obtains IP rights in return for a promise to pay royalties on an ongoing basis to the original IP owner.[1] For example, within the realm of patents, an agreement may involve an "assignment" or

[1] In this case, City of Hope was the original "IP owner" because it conveyed to Genentech the rights to own, patent, and use certain IP developed by City of Hope scientists. Genentech was the "IP user" because Genentech obtained those IP rights from City of Hope.

outright sale of a patent. An agreement instead may convey a "license" or right to exploit the patented invention. As an alternative, an IP owner may sell the right to own and patent a potential invention in exchange for research funding as well as future royalties, as occurred in this case. Although this case arose from patented technology, copyright licenses and assignments may raise similar issues.

IP agreements have been critical to the economic growth and development of California, the United States, and, indeed, the world. Intellectual property assets have become increasingly significant within the world economy, accounting for more than 20% of world trade.[2] Patent licensing revenues alone increased from $15 billion in 1990 to well over $120 billion in 1999, and are expected to reach over $500 billion by the middle of the next decade.[3] Royalties and license fees accounted for $43 billion of U.S. exports in 2002, up from $20 billion in 1992.[4]

The amici and their members include IP owners as well as IP users, and have a strong economic interest in seeing that IP users fulfill their royalty obligations. That goal is fully met by contract damages and by privately negotiated contract provisions designed to ensure that IP users will properly pay and account for royalties. If this Court affirmed the fiduciary-

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[2] Clarkson, *Avoiding Suboptimal Behavior in Intellectual Asset Transactions: Economic and Organizational Perspectives on the Sale of Knowledge* (2001) 14 Harv. J.L. & Tech. 711, 714-715.

[3] Burton et al., *Strategic Role of Intellectual Property in Company Valuation and Financing*, *in* Handling Intellectual Property Issues in Business Transactions (2002) pp. 9, 20. In 2001, IBM alone earned $1.7 billion licensing its patents. See *More Rembrandts in the Attic: Britain's BT Hopes to Make Money From Dusting Off Its Patents* (Jan. 19, 2002) Economist, p. 53.

[4] See U.S. Census Bureau, U.S. International Trade In Goods and Services (2002 Final Revision) pp. 2, 61, at http://www.census.gov/foreign-trade/Press-Release/2002pr/Final_Revisions_2002/.

duty aspect of the judgment, however, IP owners could raise the spectre of punitive damages in every royalty dispute.

Imposing fiduciary status as a cost of using third-party IP would severely impede the productive flow of ideas from inventors to those who can most effectively bring those ideas to the public. A tort-based regime would particularly threaten the high-technology sector, where IP agreements are common, and where agreements to fund research and development are critical to innovation. As risk increased, prudent IP users would avoid entering into IP agreements that place them at such a decided disadvantage relative to IP owners. This reluctance would especially reduce investment in research and development for IP that is not yet patented—that is, the very newest technologies with the greatest potential social value.

The significance of the tort component of this case extends beyond IP. If this Court were to characterize one set of common commercial contracts as fiduciary relationships, more courts might follow with their own discoveries of fiduciary duties in other contract settings. Once allowed outside its traditional boundaries, the fiduciary concept could produce an ever-expanding tort-based regime where businesses—on pain of punitive damages—are expected to be accommodating rather than efficient. That is bad law, bad economics, and bad social policy. This Court should adhere to the established principles distinguishing tort from contract, and arm's-length dealing from fiduciary solicitude, to reverse the tort verdict and vacate the punitive damages award.

ARGUMENT

The $200 million tort judgment depends on the validity of this jury instruction:

> A fiduciary relationship arises when a person entrusts a secret idea or device to another under an arrangement whereby the other party agrees to develop, patent and commercially exploit the idea in return for royalties. (RT 18406:6-11.)

That is, to affirm the judgment here, this Court would have to hold that any IP user that obtains rights to another's IP before the IP has been patented or otherwise made public—if not, indeed, anyone who agrees to pay royalties for IP rights—becomes the IP owner's fiduciary. Moreover, this Court would have to hold that an IP user risks punitive damages when it disputes the scope of its royalty payment and reporting obligations.

Holding that IP agreements create *per se* fiduciary relationships would expand the scope of a relationship that the Supreme Court has strictly limited. The purpose and effect of that expansion—to make tort remedies available for contractual breach—would serve a goal that the Court has consistently rejected. And the practical result of affirmance would be to inhibit commerce in intellectual property. The tort judgment is not sustainable, and should be reversed.

I. THE CALIFORNIA SUPREME COURT HAS CONSISTENTLY REJECTED SIMILAR EFFORTS TO SECURE TORT DAMAGES FOR BREACH OF CONTRACT.

The expansion of fiduciary duties in this case should be seen for what it is: a distortion of familiar legal doctrine to transform a contract breach into a tort. The California Supreme Court has repeatedly refused to make tort remedies available for breach of noninsurance contracts—even for breaches committed intentionally and in bad faith. Rather, the Court has instructed, "[a] person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations." *Aas v. Superior Court* (2000) 24 Cal.4th 627, 643.

The Court has returned to this principle in refusing to recognize tort remedies for a wide variety of contractual breaches that lack grounding in a legal duty separate and independent from the contract itself. Thus, the Court extinguished two short-lived sham torts: intentionally interfering with one's own contract and denying the existence of a contract to which one allegedly is a party (a transparent way of recharacterizing a contractual breach). See *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503 (limiting intentional interference); *Freeman & Mills, Inc. v. Belcher Oil Co*. (1995) 11 Cal.4th 85 (abrogating the so-called *Seaman's* bad-faith-denial tort). Unless a disappointed contractor can plead and prove a tort distinct from mere nonperformance of an agreement, only contract remedies are available.

Although the subject matter of the contract—a "secret idea or device," *i.e.*, IP—was the basis for imposing fiduciary duties and tort remedies in this case, the Supreme Court has rejected similar efforts to extend tort remedies to categories of contractual breaches that involve supposedly sensitive subject matter. Thus, wrongful termination of an employee raises only a contract claim unless the termination independently violates a fundamental public policy. See *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654; *Hunter v. Up-Right, Inc.* (1993) 6 Cal.4th 1174, 1180-1182. And defective performance of a construction contract is no tort unless the breach physically injures a person or damages property apart from the building itself. See *Aas*, 24 Cal.4th 627; see also *Erlich v. Menezes* (1999) 21 Cal.4th 543 (causing emotional distress does not make breach of construction contract tortious).

Insurance contracts remain the sole exception to this rule. Because the insurance exception represents "a major departure from traditional principles of contract law," the Supreme Court has refused to extend that exception to any other contractual setting and repeatedly has "cautioned courts to exercise great care" in considering whether to do so. *Cates Construction, Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 46 (internal quotation marks omitted); accord *Freeman & Mills*, 11 Cal.4th at 94; *Foley*, 47 Cal.3d at 690. Indeed, the Supreme Court did not extend the "insurance exception" even to construction performance bonds, which the Insurance Code recognizes as a type of "insurance." *Cates*, 21 Cal.4th at 46.

In deciding these cases, the Court has relied on several "compelling *policy* reasons supporting the preclusion of tort remedies for contractual breaches outside the insurance context." *Freeman & Mills*, 11 Cal.4th at 97 (emphasis in original). The same considerations should preclude misuse of fiduciary principles to provide tort remedies for breaches of IP agreements.

(1) Contract and tort law are structurally separate areas of the law that promote different objectives and afford different remedies. Reaffirming that "[c]ontract and tort are different branches of law," *Applied Equipment*, 7 Cal.4th at 514, the Court has enforced a structural separation between the two areas based on their differing policy objectives: "Contract law exists to enforce legally binding agreements between parties; tort law is designed to vindicate social policy." *Id.*; see also *Foley*, 47 Cal.3d at 683. As a consequence,

> [w]hereas an intentional tort is seen as reprehensible—the deliberate or reckless harming of another—the intentional breach of contract has come to be viewed as a morally neutral act, as exemplified in Justice Holmes's remark that "[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and noth-

ing else."

Freeman & Mills, 11 Cal.4th at 106 (Mosk, J., concurring and dissenting) (quoting Holmes, *The Path of the Law* (1897) 10 Harv. L. Rev. 457, 462).

In rejecting the so-called *Seaman's* tort for bad-faith denial of a contract's existence, the Supreme Court observed that almost any resistance by a breaching party could be characterized as tortious if firm adherence to a bargaining position, or "stonewalling," is enough to trigger tort remedies: "Such conduct by the breaching party, essentially telling the promisee, 'See you in court,' could incidentally accompany *every* breach of contract." *Freeman & Mills*, 11 Cal.4th at 103 (emphasis in original). The Court's answer: *no* stonewalling by noninsurers is tortious. *Id.*

Because motive is irrelevant to contract law, contract damages provide compensation—not punishment. *Foley*, 47 Cal.3d at 683. By contrast, "punitive or exemplary damages, which are designed to punish and deter statutorily defined types of wrongful conduct, are available only in actions 'for breach of an obligation *not* arising from contract.'" *Applied Equipment*, 7 Cal.4th at 516 (quoting Civil Code § 3294(a) (emphasis added)). Punitive damages are not available even for a fraudulent or malicious breach of contract. *Id*.

This Court would substitute tort principles for contract if it held that fiduciary relationships arose from the obligations assumed in a broad category of IP agreements. Because the supposed "fiduciary" duties would be co-extensive with the contractual obligations, allowing punitive damages for their breach would squarely conflict with Supreme Court jurisprudence.

(2) Private ordering through contract promotes stability and predictability in commercial relations. The Supreme Court has stressed "the need for stability and predictability in commercial affairs." *Freeman &*

Mills, 11 Cal.4th at 102; see also, *e.g.*, *Foley*, 47 Cal.3d at 683. Tort remedies undermine contractual stability because they render contracting parties "subject to volatile and unpredictable juries that frequently act without regard to legal instructions." *Foley*, 47 Cal.3d at 695 (citation and quotation marks omitted) (discussing jurors' partiality to wrongful-termination claims). Injecting punitive damages into IP agreements would make an important category of commercial relations far less stable and predictable.

(3) Privately negotiated contracts provide a means for organizing business relations that is superior to* post hoc *reliance on a web of tort duties imposed by operation of law. Restricting tort damages in contract cases "encourag[es] contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise" and to allocate those risks contractually. *Erlich*, 21 Cal.4th at 550 (quoting *Applied Equipment*, 7 Cal.4th at 515). The parties to a contract "agree upon the rules and regulations which will govern their relationship" and that "define their respective obligations, rewards and risks." *Applied Equipment*, 7 Cal.4th at 517 (quoting brief of respondent in that case). Contract law enforces the obligations that each party has voluntarily assumed, and provides only the benefits each legitimately expected to receive under the agreement. *Id.* These "restrictions on contract remedies * * * protect the parties' freedom to bargain over special risks" and "promote contract formation by limiting liability to the value of the promise." *Freeman & Mills*, 11 Cal.4th at 98 (quotation marks and citation omitted).

By contrast, imposing a tort remedy may upset the carefully negotiated balance of power within a contractual relationship. For that reason, the Supreme Court refused to impose tort remedies that would cause "a significant shift in the balance of power between" a whole range of contracting parties; if the availability of expanded remedies would actually encourage the formation of agreements, parties would negotiate for those remedies. *Cates Construction*, 21 Cal.4th at 61; see *id.* at 57. Transforming a given set of contract duties into the basis for a tort, however, may make the risk of breach unacceptable. Allowing one side of a contract to "wield the club of tort and punitive damages" could coerce the other to "pay[] questionable * * * claims, or pay[] more on properly disputed claims," rather than "risk the outcome of a tort action." *Id.* at 58.

While "fear" of "giv[ing] rise to potential tort recovery" could deter efficient business conduct, see *Foley*, 47 Cal.3d at 696; see also *Freeman & Mills*, 11 Cal.4th at 109 (Mosk, J., concurring and dissenting), cabining tort remedies promotes efficient results. That is a particularly important policy goal in the context of IP development.

(4) Limited contract remedies encourage parties to avoid needless litigation. The Supreme Court repeatedly has voiced concerns that allowing tort recovery in contract cases "may open the door to increased * * * litigation." *Cates*, 21 Cal.4th at 59; see also, *e.g.*, *Freeman & Mills*, 11 Cal.4th at 102 (noting "overcrowded court dockets"). This could occur for at least two reasons. *First*, the allure of punitive damages may encourage a contractual party to take unreasonable positions that result in litigation, since actual or threatened tort litigation may produce a much greater payday than successfully negotiated contractual compliance. See *Cates*, 21 Cal.4th at 58. *Second*, once litigation ensues, attaching tort remedies to contract claims inevitably results in "an expensive and time-consuming expansion of [contract] litigation into an inquiry as to the motives and state of mind of the breaching party. * * * The insult to commercial predictability and certainty" is exceeded only by "the increased burden on the already overworked judicial system." *Freeman & Mills*, 11 Cal.4th at 97 (quotation marks and citation omitted). If affirmed, the huge and well-publicized tort verdict in this case would only exacerbate these adverse effects.

(5) Extending tort remedies further into the commercial environment could injure the State's economy. The Supreme Court has recognized the potential harm to California's economy that would result from the profligate extension of tort remedies to contract breaches. Thus, in *Cates Construction*, the Court predicted that extending tort remedies to surety contracts would contribute to "the unaffordability of bonds." 21 Cal.4th at 59. In *Erlich*, the Court noted that "adding an emotional distress component to recovery for construction defects could increase the already prohibitively high cost of housing in California, affect the availability of insurance for builders, and greatly diminish the supply of affordable housing." 21 Cal.4th at 560. And in *Foley*, the Court warned that "[t]he expansion of tort remedies in the employment context has potentially enormous consequences for the stability of the business community" (47 Cal.3d at 699) because it could "alter profoundly the nature of employment, the cost of products and services, and the availability of jobs" (*id.* at 694). In Justice Mosk's forthright phrase, applying tort remedies to contracts threatens to "discourage commerce." *Freeman & Mills*, 11 Cal.4th at 109 (Mosk, J. concurring and dissenting). Similarly, using fiduciary duties as a path to tort remedies in the IP context would increase the costs associated with IP agreements, discouraging trade and investment in IP and thus impeding the development of IP itself.

(6) It is practically impossible to define a workable standard distinguishing "tortious" contractual breaches from others. Courts have found it nearly impossible to draw anything resembling a "bright line" between ordinary contract breaches and those meriting tort recoveries. Rather, as the *Seaman's* experiment demonstrated, "confusion and conflict" become the order of the day when contract bleeds over into tort. *Freeman & Mills*, 11 Cal.4th at 96; see also *Erlich*, 21 Cal.4th at 560 (tort rule "cannot provide any principled limit on liability"). Without a clear and principled standard, there is a "potential for converting every contract breach into a tort, with accompanying punitive damage recovery." *Id*. at 553. It becomes "difficult if not impossible to formulate a rule that would assure that only 'deserving' cases give rise to tort relief." *Foley*, 47 Cal.3d at 697.

The jury instruction in this case provided no limiting principle. As City of Hope explains it, a "royalties-for-patents deal" (RB 41) creates fiduciary duties by virtue of the "entrustment" of IP to the licensee or assignee (RB 89). Because any breach of contract necessarily breaches the fiduciary's duty to subordinate its interests to those of the beneficiary (RB 91), any contractual breach would be tortious.

(7) The Legislature's superior ability to craft remedies counsels against judicially expanding torts to reach additional business transactions. The Supreme Court repeatedly has held that any expansion of tort remedies into the contract setting should be left to the Legislature. That body, the Court has observed, is better equipped than the judiciary to gather data, to study the effects of "a significant shift in the balance of power" between contracting parties, and to determine whether statutorily authorized tort remedies would benefit the industry in question. *Cates*, 21 Cal.4th at 60-61; see also *Erlich*, 21 Cal.4th at 560; *Foley*, 47 Cal.3d at 700.

II. CATEGORIZING IP AGREEMENTS AS "FIDUCIARY" DISTORTS THE LAW OF FIDUCIARY RELATIONS AND VIOLATES THE PUBLIC POLICIES PRECLUDING TORT REMEDIES FOR BREACHES OF CONTRACT.

Calling IP users the "fiduciaries" of IP owners uses the breach-of-fiduciary-duty label as a fig leaf for a revived effort to make some contractual breaches into "bad faith" torts. See Scallen, *Promises Broken vs. Promises Betrayed: Metaphor, Analogy, and the New Fiduciary Principle*, 1993 U. Ill. L. Rev. 897, 928. Under either label, juries may dispense punitive damages for breaches of contract on an *ad hoc* basis.

Fiduciary duties are not some type of flexible device to insert tort remedies into contracts. To the contrary, the California Supreme Court has largely excluded fiduciary duties from the contractual setting, preferring to treat businesses (and individuals) as responsible adults capable of ordering their affairs by agreement without the intrusion of paternalistic legal rules. The Court's preference for private ordering in contract cases sharply conflicts with the expansion of fiduciary duties below.

A. IP Agreements Provide No Basis For Transplanting The Law Of Fiduciaries Into A Purely Commercial Sphere.

The jury was instructed that fiduciary duties *categorically* arise whenever an inventor "entrusts"—in exchange for royalty payments—a "secret" idea or invention to another who "agrees to develop, patent and commercially exploit the idea." RT 18406.[5] Under that definition, at a minimum, any enterprise that contracts for the rights to unpublished and undeveloped intellectual property rights becomes the inventor's trustee.

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[5] We assume that the tort judgment rests solely on the quoted instruction defining a category of fiduciary relationships, as neither party's brief identifies another basis in the jury instructions for imposing fiduciary duties.

Indeed, given the ambiguity of the "entrustment" and "secrecy" elements, any enterprise that simply agrees to pay royalties risks fiduciary status.

City of Hope offers nothing but its own *ipse dixit* to assure the Court that affirmance would not "suggest[] that a royalty agreement * * * or a license or an assignment, without much more, can give rise to a fiduciary relationship." RB 89. "Much more" turns out to be toothless "pre-requisites of entrustment, dependency, and control" (*id.*) that seem to be satisfied by any assignee or licensee responsible for commercializing IP. Any license or assignment "entrusts" IP to the IP user, any licensee or assignee "controls" both the commercialization of the IP and the royalty flow, and any IP owner is "dependent" on its licensee or assignee for royalty payments.

Such a broad extension of fiduciary duties into the relation between IP owners and IP users contradicts established principles governing the fiduciary relationship. IP users are not IP owners' trustees.

1. *The Relationship Between IP Users And IP Owners Has None Of The Traditional Characteristics Of A Fiduciary Relationship.*

Fiduciary duties arise where some fundamental aspect of a relationship between two parties leaves one party inevitably dependent on the other and unable adequately to protect itself through contract, so that the fiduciary has a duty to place the beneficiary's interest before its own. Tort liability for a breach of fiduciary duty rests on the pre-existing status or relation of the parties; fiduciary duties cannot arise from the terms or subject matter of "an agreement or contractual relation between the fiduciary and the beneficiary." Restatement (Second) Torts (1979) § 874, Com. b (quoted in *Richelle L. v. Roman Catholic Archbishop* (2003) 106 Cal.App.4th 257, 273)). But while "[t]he essence of a fiduciary or confidential relationship is that the parties do not deal on equal terms," *Beery v. State Bar* (1987) 43 Cal.3d 802, 813 (internal quotation marks omitted), there is no inherent imbalance between IP users and IP owners. The exclusive rights of IP *owners*, the beneficiaries of the fiduciary relation imposed below, counterbalance any economic power held by particular IP users. And imbalance alone does not suggest fiduciary duties in any event: even consumers subject to adhesion contracts are not the fiduciary wards of their vendors or lenders. See *Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 221-222; *Nymark v. Heart Fed. Sav. & Loan Ass'n* (1991) 231 Cal.App.3d 1089, 1093; *Copesky v. Superior Court* (1991) 229 Cal.App.3d 678, 692-694.

Voluntary subordination of one's own interests to another's is the distinguishing mark of a fiduciary relationship. *Committee*, 35 Cal.3d at 222; *Nymark*, 231 Cal.App.3d at 1093 n.1.[6] A fiduciary not only "*undertakes* to act *in the interest of another*," Scott, *The Fiduciary Principle* (1949) 37 Cal. L. Rev. 539, 540 (emphasis added); see *Committee*, 35 Cal.3d at 221, but also agrees to "giv[e] priority" to the beneficiary's inter-

[6] See also, *e.g.*, Black's Law Dictionary (6th ed.1990) p. 625; *Jones v. Ellis* (Ala. 1989) 551 So.2d 396, 402-403; *Destefano v. Grabrian* (Colo.1988) 763 P.2d 275, 284 ; *Andersen v. Albert & J.M. Anderson Mfg. Co.* (Mass. 1950) 90 N.E.2d 541, 543; *Wallad v. Access BIDCO, Inc.* (Mich. App. 1999) 600 N.W.2d 664; *Rosencrans v. Fry* (N.J. 1953) 95 A.2d 905; *Continental Potash, Inc. v. Freeport-McMoran, Inc.* (N.M. 1993) 858 P.2d 66, 77; *Belvedere Condominium Unit Owners' Ass'n v. R.E. Roark Cos., Inc.* (Ohio 1993) 617 N.E.2d 1075, 1082; *Pickens v. Hope* (Tex. App.–San Antonio 1988, writ denied) 764 S.W.2d 256, 267 (citing *Slay v. Burnett Trust* (Tex. 1945) 187 S.W.2d 377, 387-388); *Elmore v. State Farm Mut. Auto. Ins. Co.* (W.Va. 1998) 504 S.E.2d 893, 898.

ests. *Id.* at 222. Indeed, in most instances, "a fiduciary * * * forgoes the opportunity to act in his own interest at all."[7]

This element of voluntary unselfishness makes no sense at all in arm's-length dealings between business people. Commerce in general, and the development and commercialization of technology in particular, are profit-seeking activities, not altruistic ones. As a consequence, the classic fiduciary relationships do not fit the commercial context except where specialized, inherently altruistic services are supplied. Thus, a trustee's or an attorney's services by definition involve a heightened level of trust and a subjugation of interest to the client or beneficiary. By contrast, the obligations of an IP user who pays to use IP come at arm's length.

Three broader types of business relationship—partnership, joint venture, and agency—*do* prompt fiduciary duties because one or more parties *do* undertake to act for others or for a common business entity. But the parties here agreed that their relationship here did *not* involve any of those relationships—*i.e.*, that neither undertook to act for the other. See 39 AA 10580 (Article 11.01). In light of the California Supreme Court's preference for private ordering of obligations through contract, this Court should give effect to an unambiguous contractual disclaimer of "relationship[s] that would connote [fiduciary] duties." *City Solutions, Inc. v. Clear Channel Communications, Inc.* (N.D. Cal. 2002) 201 F.Supp.2d 1048, 1050. "[V]oluntary contractual arrangements" should prevail over any judicial sense of "proper business decorum." *Freeman & Mills*, 11 Cal.4th at 99

[7] Burton & Andersen, Contractual Good Faith: Formation, Performance, Breach, Enforcement (1995) § 9.2.2. n.20. See Restatement (Second) Trusts (1959) §§ 2, 170; see also Restatement (Third) Trusts (2003) § 2.

(quoting *Oki America, Inc. v. Microtech Int'l, Inc.* (9th Cir. 1989) 872 F.2d 312, 316 (Kozinski, J., concurring)).[8]

To fashion, nonetheless, a new categorical fiduciary duty to cover IP agreements *despite the absence of* a joint venture, agency or partnership relation would conflict with deeply rooted California jurisprudence. From the earliest days, California courts have confined fiduciary duties to a strictly limited set of "peculiar relation[s]." *Robins v. Hope* (1881) 57 Cal. 493, 497 (citing 1 Story's Equity Jurisprudence 218), overruled in part on other grounds, *Seeger v. Odell* (1941) 18 Cal.2d 409, 416; see also *Bacon v. Soule* (1912) 19 Cal.App. 428, 433-435 (brother is not sister's fiduciary). The few, traditional fiduciary relationships are "legally defined and regulated," *Richelle L.*, 106 Cal.App.4th at 271, and include trustee/beneficiary, guardian/ward, corporate director/shareholder, agent/principal, joint venturer/co-venturer, and attorney/client. *Id.* at 270-271; *Wolf v. Superior Court* (2003) 107 Cal.App.4th 25, 30.

The Supreme Court has closely confined *per se* fiduciary relationships to these traditional categories, excluding contracts and contractual activities from that scope. Thus, the Court recently made clear that, notwithstanding the added tort and contract duties owed by an insurer to its insured, an insurer is *not* a true fiduciary. *Vu v. Prudential Prop. & Cas. Ins.*

[8] One panel of the Court of Appeal, confronting a contractual provision labeling one party as an independent contractor, asserted that a joint venture may exist "despite an express declaration to the contrary." *April Enterprises, Inc. v. KTTV* (1983) 147 Cal.App.3d 805, 820. But *April Enterprises* did not involve an explicit *disclaimer* of any *joint venture*. Neither did *Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 Cal.2d 751, 765, the sole support cited in *April Enterprises*. And neither did *O.K. Boiler & Welding Co. v. Minnetonka Lumber Co.* (Okla. 1924) 229 P. 1045, 1047-48, on which *Universal Sales* relied, nor *Fewell v. American Surety Co.* (Miss. 1900) 28 So. 755, on which *O.K. Boiler* relied. Indeed, the three earlier cases involved no express characterizations or disclaimers at all.

Co. (2001) 26 Cal.4th 1142, 1150-1151. The Court likewise refused to interfere with an agreement between competent adults by extending the boundaries of the established, traditional fiduciary relationship between spouses to encompass persons who were merely engaged to be married. *In re Marriage of Bonds* (2000) 24 Cal.4th 1, 27-30.

But a far broader extension beyond recognized, "well-defined categories of law" (*Richelle L.*, 106 Cal.App.4th at 272) would be needed for a categorical fiduciary duty to run from IP users to the IP owners with whom they contract. The Supreme Court long ago confirmed the obvious: the relationship of contract is not one of the traditional fiduciary relationships. *Gonsalves v. Hodgson* (1951) 38 Cal.2d 91, 99. Duties to pay royalties on licensed or assigned IP are no different in this respect from other contractual debts and obligations. See, *e.g.*, *Wolf*, 107 Cal.App.4th at 30-33.[9]

In disapproving efforts "to call upon the law of fiduciary relationships to perform a function for which it was not designed and is largely unsuited," *Committee*, 35 Cal.3d at 222, the Supreme Court has returned to the bedrock principle that a "course of arm's-length dealing" flatly precludes any "duty of loyal representation of the opposing party." *Gonsalves*, 38 Cal.2d at 99 (internal quote omitted). Buyers and sellers are "held to the mores of the marketplace," *Committee*, 35 Cal.3d at 222, unless they agree

[9] City of Hope relies (RB 82-83 n.25) on several decisions that used the term "fiduciary" for the sole purpose of providing a plaintiff with an action for unjust enrichment when IP had been used *without* a contract. That purpose no longer supports the imposition of a fiduciary duty (if indeed full fiduciary duties were imposed or intended in those cases). Rather, under current California law, recovery for unjust enrichment does not depend on the existence of a fiduciary duty, but is available to prevent inequity whenever (but only when) no contract governs the relation between the parties. See, *e.g.*, *California Med. Ass'n v. Aetna U.S. Healthcare, Inc.* (2001) 94 Cal.App.4th 151, 171-173 & n.23.

to subordinate their interests to act on their counterparts' behalf. *Nymark*, 231 Cal.App.3d at 1093 n.1.

An IP owner's royalties result from the IP user's pursuit of self-interest, not from its subordination of self-interest. If IP users owed IP owners the fiduciary duty of undivided loyalty that City of Hope presses as the basis for liability here (see RB 91), there would be no more IP agreements, since only an altruist would enter into an agreement in which it was doomed to lose every dispute.

2. *The* **Stevens** *Formulation Rests On Premises Rejected By The California Supreme Court And This Court.*

The jury instruction imposing a categorical fiduciary duty on IP users paraphrased one of several formulations offered to justify the result in a straightforward fraud case, *Stevens v. Marco* (1956) 147 Cal.App.2d 357. *Stevens'* comments about fiduciary relations are not good law.

Stevens cannot support imposing a fiduciary duty whenever a contract calls for a party to share a "secret" of some kind. The Supreme Court has held unequivocally to the contrary. Rather, the Court made clear, the mere transmission of a "secret" does not *create* a "fiduciary-like" confidential relationship (much less a truly fiduciary relation), but only triggers additional duties imposed by any "protective context" that arose from the parties' *prior* dealings or relationship. *Davies v. Krasna*, 14 Cal.3d at 510-511. The plaintiff in *Davies* submitted a short story "in confidence" to the defendant, who (without informing or compensating the plaintiff) incorporated the gist of the story into a commercially successful play. *Id.* at 504. The plaintiff contended that this conduct amounted to a "violation of a *duty* arising from a confidential *relationship*" that had arisen from the very transmission of the unpublished story. *Id.* at 510 (emphasis added).

The Court, speaking through Justice Tobriner, held that delivering a commercially exploitable idea to another for exploitation—"entrust[ing] a secret idea or device to another" (RT 18406) in the words of the jury instruction here—did not "impose upon" the recipient "the fiduciary-like duties that arise from a confidential relationship." *Davies*, 14 Cal.3d at 511. The Court explicitly contrasted the attorney-client setting in *Stevens*, in which an inventor "transmit[s] the idea *in the protective context* of a confidential relationship" that is based on something other than the transmission itself, with the setting of *Davies* (and this case). *Id.* at 510. In the latter situation, in which an idea was "transmitted *in the course of arm's length negotiations between businessmen* who can profit from its exploitation," no pre-existing "protective context" subjected the dealings of the parties to additional tort duties. *Id.* (emphasis added). Thus, under current law, transmitting an idea or invention in an arm's-length IP agreement does not generate a fiduciary relationship any more than a royalty obligation would.

The *Stevens* court's contrary ruminations rested on the overbroad proposition that a fiduciary relationship exists "whenever trust and confidence is reposed by one person in the integrity and fidelity of another," even in the context of an arm's-length commercial contract. 147 Cal.App.2d at 372. Since then, however, this Court has repeatedly explained that "no fiduciary relationship is established merely because the parties reposed trust and confidence in each other." *Girard v. Delta Towers Joint Venture* (1993) 20 Cal.App.4th 1741, 1749 (internal quotation marks omitted); *Worldvision Enters., Inc. v. ABC* (1983) 142 Cal.App.3d 589, 595. As Division Seven recently observed, "*[e]very* contract requires one party to repose an element of trust and confidence in the other to perform," but that is the basis for the implied covenant of good faith and fair dealing, not for fiduciary duties. *Wolf*, 107 Cal.App.4th at 31 (emphasis added). Although the language in older decisions may conflate the implied covenant with an indistinct fiduciary duty, the distinction between those principles is now clear.

Stevens also provides no valid basis to extend fiduciary duties to every contract involving actions undertaken for the parties' "mutual benefit." 147 Cal.App.2d at 374. *All* contracts presumably rest on a mutual perception that performance "would inure to the parties' joint benefit," but that characteristic cannot and does not produce fiduciary duties in its wake. *Wolf*, 107 Cal.App.4th at 33.

Fiduciary duties, by contrast, arise only if the purported fiduciary exercises control over the beneficiary's property or business affairs—*not* because it paid to buy or use property as an IP user does, but because it agreed to subordinate its own interests to those of the beneficiary. See *Vai v. Bank of America* (1961) 56 Cal.2d 329, 338; *Recorded Picture Co. v. Nelson Entm't, Inc.* (1997) 53 Cal.App.4th 350, 370; *Nymark*, 231 Cal.App.3d at 1093 n.1.[10] An IP licensee's "control" over IP results from the licensee's *paying* to use the property in its *own* interest, by contrast with a trustee or other agent (like an attorney or stockbroker) who generally *is paid* to take control of the property of the beneficiary or principal. "Control" over another's property that results from an agreement to *pay* for that

[10] Although *Stevens* (147 Cal.App.2d at 373) and City of Hope (RB 80-81) purport to draw support from *Hollywood Motion Picture Equip. Co. v. Furer* (1940) 16 Cal.2d 184, that straightforward application of the law of bailments says nothing about fiduciary duties, nor can an IP agreement of the type at issue here be rationally confused with a bailment.

privilege does not give rise to fiduciary duties in the context of IP agreements any more than a rental agreement makes the renter the fiduciary of the landlord or chattel owner. And, of course, when an IP owner *sells* its IP outright in an assignment contract, the IP is the property of the assignee, not the assignor. See generally Einhorn, Patent Licensing (2002) § 1.01[1][b], at 1-11 to 1-13. Cf. *Continental Potash*, 858 P.2d at 77.

In any event, despite the broader language of the opinion, *Stevens* presented two traditional bases for fiduciary duties, neither of which is present in IP agreements generally: attorney-client and joint venture relations. Although City of Hope downplays the attorney-client setting (RB 74 n.18), the California Supreme Court pigeonholed *Stevens* as involving "an inventor" who "reveal[ed] his concept to a patent lawyer" (*Davies*, 14 Cal.3d at 510), and *contrasted* that situation with one in which a "secret" was transmitted through arm's-length negotiations (*id*. at 511). And the *Stevens* court itself found that the parties' relationship was equivalent to a joint venture (147 Cal.App.2d at 374-376), because both parties were involved in the research, development, promotion, and marketing of their joint product, and the contract in *Stevens* did not disclaim the joint venture relation.

Thus, at the time of the IP assignment and formation of the venture, the defendant in *Stevens* was both the plaintiff's attorney and the plaintiff's joint venturer.[11] If the authority of *Stevens* persists at all, it is only insofar as it applies those traditional fiduciary categories. The broader statements in the case no longer reflect the law of this State.

[11] City of Hope's assertion (RB 74 n.18) that the inventor had separate counsel at "critical times" ignores the *most* critical time in the relationship—its formation, when the inventor put himself in the patent attorney's hands. The inventor assigned the IP and created the venture with the patent attorney nearly two years before retaining separate counsel after a dispute to revise the terms of the agreement. *Stevens*, 147 Cal.App.2d at 363-364.

B. No Public Policy Supports Adding Fiduciary Duties Atop The Ample Contractual Means Available To Preserve IP Owners' Rights.

A new fiduciary duty (and new tort) tailored to IP agreements would not "vindicate" any significant "social policy." *Applied Equipment*, 7 Cal.4th at 515. Using tort duties to reorder relations in IP agreements is unnecessary—indeed, counterproductive—because common contract provisions apparent in any licensing treatise or form book provide all the protection that any IP owner could need, and do so in a far more orderly and predictable manner. By contrast, we are aware of no reference recommending that parties insert language explicitly imposing fiduciary duties or punitive damage remedies into their IP agreements.

That is because a reasonably well-drafted IP agreement can provide contractual incentives to develop and commercialize a "secret" product. To sharpen these incentives, parties can agree to a flat, minimum royalty payable whether or not the IP user generates any revenue from the invention. Contract terms also can explicitly require the IP owner to use its "best efforts" to exploit the invention. Minimum-royalty provisions and best-efforts clauses are familiar to both the form books and the courts.[12] Tort duties are superfluous.

In addition, IP licenses routinely contain contractual provisions that encourage the timely and accurate payment of royalties. Parties may agree to "royalty audits" and to provisions on recordkeeping and retention, in-

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[12] *E.g.*, *Alling v. Universal Mfg. Corp.* (1992) 5 Cal.App.4th 1412 (best efforts clause); *Sass v. Hank* (1951) 108 Cal.App.2d 207 (minimum royalty); *Schrank v. Sterling Prods. Co.* (1939) 33 Cal.App.2d 107 (same); Barrett, *The Patent License: Standard Clauses and Variations*, in Practising Law Institute, Technology Licensing and Litigation: 1995 (1995) pp. 211, 228-29 (minimum royalties), 236-37 (best efforts or due diligence clauses). See *also* 1 Eckstrom's Licensing in Foreign and Domestic Operations (2003) §§ 3:30 (minimum royalty), 3:34 (best efforts).

spection and copying of the IP user's records, periodic reporting and certification of reports, and access to the IP user's audited financial statements.[13] Parties may reduce monitoring and compliance costs and disputes by negotiating an explicit "total sales license" that makes it unnecessary to determine whether any given product infringes licensed patents or otherwise uses the IP owner's property.[14] An IP owner would pay for this expansion of the royalty *base*, of course, by reducing the royalty *rate*.

Moreover, IP owners and IP users can allocate the costs of royalty monitoring so that a wronged IP user need not pay for the privilege of discovering it was underpaid. Parties may agree to submit all royalty disputes to binding arbitration, with the loser paying the winner's attorneys' fees. See Schlicher, *Some Thoughts on the Law and Economics of Licensing Biotechnology Patent and Related Property Rights in the United States* (1987) 69 J. Pat. & Trademark Off. Soc'y 263, 283. The parties also may agree that the IP user will pay for any royalty audit that results in its royalty payments being increased by a specified percentage. Holmes, Patent Licensing: Strategy, Negotiation, Forms (2002) § 5.4.2, at 5-4 to 5-5.

Indeed, even in the absence of these types of provisions, the California Supreme Court long has recognized that a *contractual* right to an accounting is implicit in any contract calling for division of profits or pay-

[13] See Schmidt, *Royalty Audits*, in Litigation Services Handbook: The Role of the Financial Services Expert (Weil et al. eds., 3d ed. 2001) ch. 25 at pp. 1-5; Holmes, Patent Licensing: Strategy, Negotiation, Forms (2002) §§ 5:1-5:5, at 5-1 to 5-33. IP agreements routinely reflect the IP owner's "customary" right to inspect the IP user's records. Hickman, *The Patent and Technology License*, in Practising Law Institute, Understanding the Intellectual Property License (1997) pp. 251, 267.

[14] See Schlicher, *Some Thoughts on the Law and Economics of Licensing Biotechnology Patent and Related Property Rights in the United States* (1987) 69 J. Pat. & Trademark Off. Soc'y 263, 283.

ment of royalties, "for otherwise there would be no way [to] determine whether there were any profits" on which royalties were due. *Nelson v. Abraham* (1947) 29 Cal.2d 745, 751 (quoting *Elliott v Murphy Timber Co.* (Or. 1926) 244 P. 91, 92). That right to an accounting does not rest on (and does not itself create) a broad fiduciary relationship that would prompt tort duties or tort damages. *Id*.[15] Providing still further protection, the implied covenant of good faith and fair dealing precludes a party from sequestering "secret profit[s]" that an agreement calls to be divided, whether by royalty or other mechanism. *Nelson*, 29 Cal.2d at 751. That, again, is a contractual obligation, subject to enforcement for contract damages. But neither the express nor the implied contractual duties involve the one-sidedness inherent in a fiduciary relationship, where one party has a duty to put the other's interests ahead of its own.

To obtain royalty-protecting provisions beyond those implied in all royalty contracts, an IP owner must negotiate a smaller royalty or make some other concession to the prospective IP user. Imposing fiduciary duties on the contract's performance would rewrite that bargain, shifting the advantage in the IP owner's favor without giving the IP user anything in return. That unwise course would supplant the parties' carefully negotiated allocation of risks and rewards with open-ended tort remedies. Rather than giving IP users stronger incentives to account for and pay royalties in full, importing fiduciary duties into the business relationship between IP owners

[15] As a consequence, *Schaake v. Eagle Automatic Can Co.* (1902) 135 Cal. 472, which found a "fiduciary" relation solely in order to support an action for an accounting, provides no valid authority to extend a full-fledged fiduciary duty, complete with punitive damages remedies, to all assignors of patents in exchange for royalties.

and IP users would discourage the formation of any relationship—and the payment of any royalties—at all.

C. Complex And Highly Technical Disputes Over IP Agreements Should Not Be Subject To Punitive Damages.

The primary practical significance of adding fiduciary duties to IP agreements is to permit IP users to extract punitive damages for a contractual breach. As this case demonstrates, in a fiduciary regime, an IP user could face punitive damages for adhering to an interpretation of an IP agreement that was sufficiently reasonable that the trial court submitted it to the jury.[16] In effect, Genentech was punished for the very "stonewalling" that, our Supreme Court has held, cannot support even simple tort liability, much less punitive damages. *Freeman & Mills*, 11 Cal.4th at 103. A failure to deliver a promised performance is "morally neutral" even when intentional. *Id*. at 106 (Mosk, J., concurring and dissenting).

"Morally neutral" business activity of that kind, *id.*, as a genus, is not "so reprehensible as to warrant the imposition of" punitive damages, a threshold requirement that must be satisfied in order for *any* punitive damage award to be consistent with due process. *State Farm Mutual Automobile Ins. Co. v. Campbell* (2003) 123 S.Ct. 1513, 1521, 155 L.Ed.2d 585, 602. And California law precludes punitive damages even for malicious or fraudulent breaches of contract. *Applied Equipment*, 7 Cal.4th at 516. Both state and federal principles weigh against rewriting the law of fiduciary duties so that juries would routinely be able to contemplate imposing punitive damages in disputes over IP agreements.

[16] Whether the contract instead should have been construed by the court is beyond the scope of this brief.

A dispute over the scope of an IP agreement provides a particularly inappropriate setting for punitive damages liability because of the numerous uncertainties that may dictate the ultimate result.[17] Genentech disputed the breadth of the royalty obligation, refusing to pay royalties on license fees from products that did not use IP from City of Hope. California Supreme Court decisions hold that, unless the parties clearly agreed to the payment of royalties on noninfringing products, royalties are payable only on products that would infringe the licensed patents. See *Farmland Irrigation Co. v. Dopplmaier* (1957) 48 Cal.2d 208, 224-25, 227 (Traynor, J.); *Eastman Oil Well Survey Corp. v. Lane-Wells Co.* (1943) 21 Cal.2d 872, 873-874. Disputing the scope of an agreement in reliance on that principle (or similar principles of contract construction)—if it can be tortuous at all—cannot be sufficiently fraudulent or reprehensible to support punitive damages. See Civil Code § 3294.

Similar uncertainties may arise in determining whether particular products trigger a royalty obligation. Many IP agreements cover technologically sophisticated inventions that form single aspects of complex products. For those agreements, reasonable disputes may arise over the computation even of royalties that are conceded to apply only to infringing products or processes. The question of infringement is so difficult to predict that patent litigation has proliferated in the federal courts—and about one-quarter of all infringement judgments of the district courts are reversed on appeal. Harmon, Patents and the Federal Circuit (6th ed. 2003) p. 1253.

[17] In an analogous context, punitive damages are not available for wrongful use of IP under a reasonable belief that the actions were authorized by a contract. *Zelinski v. Columbia 300, Inc.* (7th Cir. 2003) 335 F.3d 633, 641-642 (trademark and unfair competition case applying Illinois law).

Adding fiduciary duties, and thus punitive damages, to the mix despite these difficulties would have two immediate deleterious effects. First, fiduciary duties would shift "the balance of power between" the parties to IP agreements. *Cates*, 21 Cal.4th at 61. Each IP user would recognize that its refusal to capitulate to the IP owner's demands—even if based on a reasonable difference of opinion about the meaning of the IP agreement—could expose it to punitive damages. Thus, because of the punitive-damage risk, fiduciary duties would deter fully legitimate business conduct. See Rubin et al., BMW v. Gore: *Mitigating the Punitive Economics of Punitive Damages* (1997) 5 Sup. Ct. Econ. Rev. 179, 184-187 (describing overdeterrence caused by punitive damages); Dorff, *Attaching Tort Claims to Contract Actions: An Economic Analysis of Contort* (1997) 28 Seton Hall L. Rev. 390, 404 (noting similar social loss from increased risk aversion).

Second, imposing fiduciary duties would make the cost of operating under an IP agreement less predictable than the cost of infringing. Infringement damages are governed (and restrained) by federal law. Patent infringement damages are primarily compensatory. Although damages may be trebled for willful infringement, see 35 U.S.C. § 284, an enhancement "is inappropriate when the infringer mounted a good faith and substantial challenge to the validity of the patent or the existence of infringement." 7 Chisum on Patents (2001) §§ 20.01, at 20-7, 20.03[4][b], at 20-331 to 20-332 (footnotes omitted).[18]

By contrast, imposing fiduciary duties on IP users would allow mere nonpayment of royalties to result in punitive damages—even if nonpay-

[18] Copyright infringement damages also are confined to "actual damages and any additional profits of the infringer," 17 U.S.C. § 504(a), although the owner may choose statutory damages of up to $30,000 per work infringed, or $150,000 per work willfully infringed. *Id.* § 504(c).

ment is based on a "good faith and substantial challenge" to the IP owner's contract interpretation. And state-law punitive damages, unlike willful-infringement damages, might exceed three times compensatory damages.[19]

Under these circumstances, a would-be IP user might well find infringement more attractive than licensing. "No potential user of a patented invention will accept a license if the cost of the license is greater than the discounted cost of losing an infringement action," Schlicher, *supra*, at 279, and the risk of massive punitive damages in a license dispute could tip the balance away from any deal. That is yet another reason why implying fiduciary duties into IP agreements makes no sense as a policy matter.

III. IF IP OWNERS NEED PROTECTION BEYOND WHAT THEY NEGOTIATE, THE LEGISLATURE, NOT THE COURTS, SHOULD PROVIDE IT.

It is difficult to understand what "social policy" would be "vindicate[d]" (*Applied Equipment*, 7 Cal.4th at 514) by reducing incentives to innovate. Imposing a categorical fiduciary duty on IP users would have that result because fiduciary duties would raise prospective IP users' costs.[20] If the cost of contracting increases, the expected result would be fewer license or assignment deals, retarding commercial exploitation of innovative new technology.

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[19] Although "few" punitive damages awards "exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process," the U.S. Supreme Court has declined to impose a bright-line upper limit on the ratio. *State Farm*, 123 S.Ct. at 1524. The California Supreme Court likewise has not imposed a limit. But see *Lane v. Hughes Aircraft Co.* (2000) 22 Cal.4th 405, 421-429 (Brown, J., concurring) (proposing a presumptive 3:1 limit).

[20] See Easterbrook & Fischel (1993) *Contract and Fiduciary Duty*, 36 J.L. & Econ. 425, 427 (noting increase in transactions costs for contractual relationships dubbed "fiduciary," and in price of the "fiduciary's" contractual performance).

In many cases, an IP owner can maximize the value of its IP rights only by assigning or licensing them to a party better situated to exploit their commercial potential. If forced to assume fiduciary duties (or even to risk that fiduciary duties might be imposed), would-be IP users would negotiate lower royalties—if they bothered to license at all. As IP rights become less marketable and thus less valuable, incentives to innovate necessarily decrease. Reducing incentives to innovate hurts the economy as much as anything that courts can do.

Because of that risk of unintended consequences, the Legislature, not the courts, should formulate any new rules to expand fiduciary duties to encompass additional business relationships. The consequences of such a sea-change in an entire area of economic activity present "empirical question[s] of fact better suited to legislative investigation and determination." *State Dep't of Health Services v. Superior Court* (2003) 31 Cal.4th 1026, 6 Cal.Rptr.3d 441, 454; see also *Cates*, 21 Cal.4th at 60-61; *Erlich*, 21 Cal.4th at 560.

The Legislature recently responded to a Supreme Court decision reaffirming the limited scope of fiduciary duties in contractual relationships. After the Court refused to extend fiduciary duties to unmarried couples entering into prenuptial agreements, the Legislature did *not* impose fiduciary duties and tort remedies. Rather, it added precise procedural prerequisites for prenuptial agreements to be enforceable as *contracts*.[21] The Legislature

[21] See SB 78, 2001-2002 Reg. Sess. (amending Fam. Code § 1615 to require, among other things, representation of each party by independent counsel (or a written waiver), "full" disclosure of property and financial information, and a 7-day review period between submission and signing of the agreement); see also 11 Witkin, Summary of California Law (9th ed. 2003 supp.) Community Property § 260, at supp. 426-427; *id.*, Husband and Wife § 12, at supp. 9-10.

properly hesitates to transform any contract relationship into one governed by tort duties. This Court should act with at least equal caution.

CONCLUSION

The judgment of the superior court should be reversed.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE
WITH CALIFORNIA RULE OF COURT 14(C)

Pursuant to California Rule of Court 14(c), and in reliance in the word count software of the program used to prepare the brief, I certify that the attached Brief of Amici Curiae contains 9,215 words, exclusive of materials not required to be included under Rule 14(c)(3).

Dated: December 19, 2003

____
Jim Hawley

PROOF OF SERVICE

I, Jim Hawley, the undersigned, declare:

1. I am employed in the County of Santa Clara, State of California. I am over the age of eighteen years and am not a party to this action. My business address is 2600 East Bayshore Road, First Floor, Palo Alto, CA 94303.

2. On December 19, 2003, I served the documents named below by placing a true copy thereof in a sealed envelope with postage thereon fully prepaid, addressed as follows:

Documents Served:

> APPLICATION OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, CALIFORNIA CHAMBER OF COMMERCE, TECHNET, INTEL CORPORATION, AND XILINX, INC. FOR PERMISSION TO FILE BRIEF OF AMICI CURIAE AND BRIEF OF AMICI CURIAE SUPPORTING THE APPELLANT

by causing true and correct copies of the above to be delivered by first-class mail from Palo Alto, California in sealed envelopes with all fees prepaid, addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct and that this declaration was executed by me on December 19, 2003.

____
Jim Hawley

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