

ARBITRATION AND MEDIATION IN THE UNITED STATES

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The substantial cost, time and risks associated with intellectual property litigation in the United States are well known. Consequently, parties frequently consider various forms of alternative dispute resolution (ADR). This paper will provide an overview of the two most common forms of ADR: arbitration and mediation.

A. The Growth of ADR in the U.S.

According to statistical data from the Federal Judicial Center, the number patent lawsuits in the U.S. increased from a total of 2112 in 1997 to 2804 in 2005. The number trademark lawsuits increased from a total of 3189 in 1997 to 3509 in 2005. Yet, on average, less than 4% of all patent suits and less than 2% of all trademark suits result in a trial. The vast majority of all IP lawsuits settle at some point, and the settlement process usually involves some form of ADR.

B. Arbitration

Congress and the federal courts, in searching to ease the overburdened court system, have strongly supported efforts to utilize ADR techniques. There is a well developed body of law regarding the enforceability of agreements to arbitrate.

1. Federal Arbitration Act

The United States Congress has shown its support for ADR by enacting the Federal Arbitration Act ("Federal Act").² The Federal Act consists of three chapters. Chapter one was originally enacted in 1947, and was based on predecessor statutes that were enacted in 1925.³ Chapter one contains general provisions about the validity and enforcement of arbitration clauses in contracts. Chapter two was enacted by Congress in 1970 upon the United States' adoption of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.⁴ Chapter two applies the provisions of Chapter one to all international commercial arbitration agreements not otherwise covered by chapter three, provided that there is no conflict with the other provisions of Chapter two. Chapter three was enacted in

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² 9 U.S.C. Secs. 1-16 & 201-08 (1970).

³ 9 U.S.C. Secs. 1-16.

⁴ 9 U.S.C. Secs. 201-08.

1990 upon the United States' adoption of the Inter-American Convention on International Commercial Arbitration.⁵

The courts have given broad application to the Federal Arbitration Act. The Supreme Court held in *Southland Corp. v. Keating* that section two of the Federal Act governs both the federal and state courts.⁶ Section two provides that: "A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."⁷ The courts have narrowly interpreted the grounds for rescinding an arbitration clause to general contract defenses such as fraud, undue influence, or overwhelming bargaining position.⁸ Section two requires the contract to "evidenc[e] a transaction involving commerce" but the requirement has been construed broadly.⁹ The Supreme Court has displayed great deference in upholding arbitration clauses--especially when the transaction involves international commerce.¹⁰

The clear message from our nation's highest court is that if a contract contains an arbitration provision, a strong presumption exists that the arbitration clause is enforceable and subject to the Federal Arbitration Act.¹¹ Section three of the Federal Arbitration Act directs a federal court to stay any lawsuit where the parties have a written agreement to refer the issue to arbitration.¹² The court may decide whether or not an issue is subject to an arbitration agreement.¹³ However, if the parties have agreed that the arbitrator shall have the

⁵ 9 U.S.C. Secs. 301-07.

⁶ 465 U.S. 1 (1984); *See also Webb v. R. Rowland & Co.*, 800 F.2d 803, 806 (8th Cir. 1986)(federal law preempts state law with respect to the interpretation and construction of arbitration agreements concerning interstate commerce.)

⁷ 9 U.S.C. Sec. 2.

⁸ *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*, 473 U.S. 643 (1985).

⁹ *Snyder v. Smith*, 736 F.2d 409, 417 (7th Cir. 1984).

¹⁰ *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*, 473 U.S. 643 (1985) (allowing for the foreign arbitration of a matter arising under U.S. antitrust law); *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974) (allowing foreign arbitration of a matter subject to United States law).

¹¹ *See Southland*, 465 U.S. at 10 11; *Mitsubishi*, 473 U.S. at 626.

¹² U.S.C. Sec. 3 ("If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.").

¹³ *AT&T Technologies, Inc. v. Communication Workers of America*, 475 U.S. 643, 646 (1985).

power to decide the scope of the arbitration agreement, then objections concerning the scope of the arbitration agreement shall be referred to arbitration.¹⁴ The intentions of the parties are "generously construed" in favor of arbitration.¹⁵ Indeed, the Supreme Court has stated that "there is a presumption of arbitrability,"¹⁶ and that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."¹⁷ The courts have favored arbitration even when arbitration results in piecemeal or inefficient proceedings.¹⁸ The Supreme Court has construed the Federal Arbitration Act as evidencing Congress' explicit mandate for a national policy favoring arbitration.¹⁹

A broadly worded arbitration clause also may reach conduct that occurs after the termination of the contract in which the arbitration clause was embedded.²⁰ In general, the presumption in favor of arbitration is so strong that the failure to exclude from arbitrability contract disputes arising after termination, far from manifesting an intent to have arbitration obligations cease with the agreement, usually affords a basis for concluding that the parties intended to arbitrate all grievances arising out of the contractual relationship.²¹

The following cases exemplify just how liberal the courts have been to find issues that are subject to arbitration. In *Southland*, the parties entered into a standard franchise agreement for 7-Eleven convenience stores.²² The agreement contained a provision requiring arbitration for "any controversy or claim arising out of or relating to this Agreement" A lawsuit was filed in a California state court, where the judge ordered arbitration for the plaintiff's claims of fraud, misrepresentation, breach of contract, and breach of fiduciary duty, but did not require arbitration for claims arising under California's franchise law. The California Supreme Court affirmed on the ground that a court should decide claims brought under the California franchise statute. However, the Supreme Court of the United States

¹⁴ *E.g., Sleeper Farms v. Agway, Inc.*, 211 F. Supp. 2d 197, 200 (D. Me. 2002) (quoting *Brandon, Jones, Sandall, Zeide, Kohn, Chalal & Musso, P.A. v. Medpartners, Inc.*, 203 F.R.D. 677, 685 (S.D. Fla. 2001)); *see also Contec Corp. v. Remote Solution*, 398 F.3d 205, 208 (2d Cir. 2005) (stating that when parties agree to arbitrate "in accordance with the Commercial Arbitration Rules of the American Arbitration Association[.]" that agreement "serves as clear and unmistakable evidence of the parties' intent to delegate" issues of scope and validity to the arbitrator).

¹⁵ *Mitsubishi*, 473 U.S. at 626.

¹⁶ *AT&T*, 475 U.S. at 4341

¹⁷ *Moses H. Cone Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24 25 (1983).

¹⁸ *Moses H. Cone Hospital*, 460 U.S. at 20; *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 215 (1985).

¹⁹ *Southland*, 473 U.S. 1, 10; *Moses H. Cone Hospital*, 460 U.S. at 24.

²⁰ *Berkery v. Cross Country Bank*, 256 F. Supp. 2d 359, 368 n.8 (E.D. Pa. 2003) (citing, inter alia, *Nolde Bros., Inc. v. Local No. 358, Bakery & Confectionary Workers Union*, 430 U.S. 243, 245-53 (1977)).

²¹ *Nolde Bros.*, 430 U.S. at 255.

²² *Southland*, 465 U.S. at 12.

reversed, and held that the Federal Arbitration Act preempted California law and withdrew the power of the states to require a judicial forum for the resolution of claims which the parties agreed to resolve by arbitration.

In *Mitsubishi v. Chrysler*, the US Supreme Court held that a party's federal antitrust claims were subject to arbitration, since the claims were encompassed by a valid arbitration contract.²³ The *Mitsubishi* arbitration clause provided for "arbitration in Japan in accordance with the rules and regulations of the Japan Commercial Arbitration Association." The Court was not persuaded by an argument that the national economic interests underlying the United States antitrust laws required resolution of those claims in a United States court. Rather, the Court reaffirmed that the federal policy in favor of arbitration "applies with special force in the field of international commerce."

2. Patent Arbitration Act

In addition to the Federal Arbitration Act, Congress has enacted legislation to ensure the enforceability of patent arbitration agreements.²⁴ Section 294(a) of the Patent Statute provides that "a contract involving a patent or any right under a patent may contain a provision requiring arbitration of any dispute relating to patents, validity or infringement arising under the contract." Section 294 further provides that "any such provision or agreement shall be valid, irrevocable and enforceable, except for any grounds that exist at law or in equity for revocation of a contract." Paragraph (b) of section 294 provides that patent arbitration proceedings shall also be governed by the Federal Arbitration Act.²⁵

Few cases have been reported under the Patent Arbitration Act. However, in those cases the courts have manifested the same liberal policy in favor of arbitration seen in other types of cases. In *Rhone-Poulenc Specialties Chimques v. SCM Corp.*, a patent holder sued its exclusive licensee for both patent infringement and breach of contract after they could not agree on the royalties due under their license agreement.²⁶ The defendant filed a motion to stay the lawsuit based on an arbitration provision in the license agreement. The district court denied the stay, but the United States Court of Appeals for the Federal Circuit reversed. It held that both the scope and infringement of the patent "are the quintessence of the agreement and that the parties intended such central determinations to be included within the scope of its broad arbitration clause."²⁷

²³ *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc.*, 473 U.S. 614 (1985).

²⁴ See 35 U.S.C. Sec. 294 (1982).

²⁵ Section 294 also addresses other aspects of patent arbitration proceedings in paragraphs (a) and (b), and contains paragraphs (c), (d), and (e), which address the finality, modification and notice of patent arbitration awards.

²⁶ *Rhone-Poulenc Specialties Chimques v. SCM Corp.*, 769 F.2d 1569 (1985); see, also *Sandata Technologies Inc. v. Care Watch, Inc.*, 2006 US.Dist. LEXIS 25312 (D.Conn.).

²⁷ *Id.* at 1572.

Similarly, in *Deprenyl Animal Health, Inc. v. University of Toronto Innovations Foundation*, a patent licensee brought a declaratory judgment action against a Canadian licensor of a United States patent, arguing that the license agreement containing an arbitration clause was inapplicable to the sale of a particular drug and that the patent was invalid, and therefore, not infringed by the sale.²⁸ The district court dismissed the action for lack of personal jurisdiction, and licensee appealed. The Court of Appeals for the Federal Circuit reversed, and held that on remand, the district court should stay proceedings in the case pending the outcome of the Canadian arbitration. It held that “Section 294 is not limited to domestic arbitration, nor is there any compelling reason to so interpret its authorization of arbitration of disputes over patent-related rights.”²⁹

In addition to the Patent Arbitration Act, Congress has also enacted legislation allowing for the arbitration of patent interference claims.³⁰ Although arbitration of interference issues has been reported in at least one case³¹, it is unlikely that details regarding agreements or understandings between parties to an interference will be reported in significant numbers given the restricted access to such agreements provided under 35 USC Section 135(c).³² Even so, one might expect the federal courts to continue to follow a broad policy in favor of arbitration of patent interference claims.

²⁸ *Deprenyl Animal Health v. University Of Toronto*, 297 F.3d 1343 (Fed. Cir. 2002).

²⁹ *Id.* at 1357; *Cf. Warner & Swasey Co. v. Salvagnini Transferica S.p.A.*, 806 F.2d 1045, 1046, 231 USPQ 972, 973 (Fed.Cir.1986) (affirming district court’s dismissal on the grounds that patent license agreement required plaintiff-licensee to bring suit in Italy).

³⁰ 35 U.S.C. Sec. 135(d) (1982) (“Parties to a patent interference, within such time as may be specified by the Commissioner by regulation, may determine such contest or any aspect thereof by arbitration. Such arbitration shall be governed by the provisions of title 9 to the extent such title is not inconsistent with this section. The parties shall give notice of any arbitration award to the Commissioner, and such award shall, as between the parties to the arbitration, be dispositive of the issues to which it relates. The arbitration award shall be unenforceable until such notice is given. Nothing in this subsection shall preclude the Commissioner from determining patentability of the invention involved in the interference.”).

³¹ *Utter v. Hiraga*, 845 F.2d 993 (Fed. Cir. 1988).

³² 35 U.S.C. Sec. 135(c) (“Any agreement or understanding between parties to an interference, including any collateral agreements referred to therein, made in connection with or in contemplation of the termination of the interference, shall be in writing and a true copy thereof filed in the Patent and Trademark Office before the termination of the interference as between the said parties to the agreement or understanding. If any party filing the same so requests, the copy shall be kept separate from the file of the interference, and made available only to Government agencies on written request, or to any person on a showing of good cause. . . .

3. Copyright Claims

Federal courts also are willing to enforce arbitration agreements concerning copyright disputes.³³ In *Saturday Evening Post* a licensor sued its licensee for copyright violations, and sought an order compelling the licensee to arbitrate the claims.³⁴ The parties' licensing contract provided that "any controversy or claim arising out of or relating to this contract, or breach thereof, shall be settled by arbitration in accordance with the Rules of the American Arbitration Association." The district court ordered the defendant to arbitrate. A panel of three arbitrators ordered the defendant to pay \$200,000 in damages for copyright infringement. The district court confirmed the arbitration award, pursuant to Section 9 of the Federal Arbitration Act.

In affirming the decision of the district court, the Court of Appeals held that the arbitration clause, which was part of a licensing contract, required mandatory arbitration over the copyright issues.³⁵ The court made reference to the Patent Arbitration Act,³⁶ and reasoned that cases involving copyright infringement should be treated in a similar manner. While the court noted that federal courts historically have held exclusive jurisdiction over copyright disputes, the court enforced the arbitration award under a federal policy of favoring the enforcement of private arbitration agreements.

4. Trademarks and Trade Secret Claim

There is no specific federal statute like the Patent Arbitration Act for trademark or trade secrets claims. However, courts readily uphold agreements to arbitrate trademark and trade secret claims. For example, in *B.V.D. Licensing Corp. v. Maro Hosiery Corp.*, the court granted the trademark licensee's motion for an order compelling a trademark owner to proceed to arbitration, and stayed the lawsuit pending final determination of arbitration proceeding.³⁷ The court noted that the "well-settled preference under federal law for arbitration requires that ambiguities concerning the scope of arbitrable issues should be resolved in favor of arbitration."³⁸ In another case, a court held that the issue of post-employment misappropriation of trade secrets was arbitrable.³⁹

³³ The court in *Kamakazi Music Corp. v. Robbins Music Corp.* held "that there is no rule against submitting copyright claims in general to arbitration, but reserved the question of whether the arbitrator may determine the validity of the copyright on which the claim was founded." 522 F. Supp. 125, 131 (S.D.N.Y. 1981), *aff'd*, 684 F.2d 228, 231 (2nd Cir. 1982).

³⁴ *Saturday Evening Post Co. v. Rumbleseat Press, Inc.*, 816 F.2d 1191 (7th Cir. 1987).

³⁵ *Id.* at 1199.

³⁶ See 35 U.S.C. Sec. 294.

³⁷ *B.V.D. Licensing Corp. v. Maro Hosiery Corp.*, 688 F.Supp. 961 (S.D.N.Y. 1988).

³⁸ *Id.* at 965

³⁹ *GATX Mgmt. Servs., LLC v. Weakland*, 171 F.Supp.2d 1159, (D.Col. 2001)

5. ITC Proceedings

At one time, there was an exception for enforcing an agreement to arbitrate an ITC complaint. In *Farrel Corp. v. United States Int'l Trade Comm'n*⁴⁰ the plaintiff sued in federal court for patent infringement and trade secret misappropriation, and also filed a Section 337 action with the U.S. International Trade Commission (“ITC”) for trade secret misappropriation and other trademark claims. Both the court and ITC stayed their proceedings in light of an arbitration clause in the parties’ license agreement. The Federal Circuit reversed the stay of the ITC proceedings. The court decided that once the ITC initiates an investigation, it can only be terminated by a determination of whether or not a violation exists, or upon entry of a consent order or approval of a settlement agreement between the parties.

Congress effectively overruled *Farrel* by enacting the amendment to 19 U.S.C. Section 1337(c).⁴¹ Now parties may agree to resolve an ITC dispute by arbitration, and the arbitration award will be recognized by the ITC.⁴²

6. Drawbacks of Arbitration

Despite ADR’s reputation for being faster and less expensive than a lawsuit, parties to a dispute often choose litigation. Parties are usually more willing to agree to non-binding forms of ADR, such as mediation. They frequently reject arbitration due to its perceived shortcomings, particularly with respect to patent disputes.

The primary objection seems to stem from the view that intellectual property rights are extremely valuable assets, and that no shortcuts should be taken to win a battle over important IP rights. Discovery can be significantly reduced (or even eliminated) in arbitration, but this may be too great of a risk in many intellectual property disputes. Since the opponent may be the best, or only, source for certain types of evidence, a party may not want to risk any limitation on discovery in arbitration. For example, a patent owner usually needs documents and depositions from the accused infringer to prove willful infringement, and the accused infringer generally needs testimony and documents from the inventor to show either the defense of "failure to disclose the best mode" or "inequitable

⁴⁰ *Farrel Corp. v. United States Int'l Trade Comm'n*, 949 F.2d 1147, 1154 (Fed. Cir. 1991).

⁴¹ See *San Huan New Materials High Tech, Inc. v. Int'l Trade Comm.*, 161 F.3d 1347, 1357 (Fed. Cir. 1998) (“we note that Farrel was overruled by statute in 1994.”)

⁴² 19 U.S.C. Sec. 1337(c) (1994) (“The Commission shall determine, with respect to each investigation conducted by it under this section, whether or not there is a violation of this section, except that the Commission may, by issuing a consent order or on the basis of an agreement between the private parties to the investigation, including an agreement to present the matter for arbitration, terminate any such investigation, in whole or in part, without making such a determination.”);

conduct." A trade secret owner often needs discovery to ascertain the full extent of the misappropriation of its trade secrets, and the alleged misappropriator often wants discovery from the trade secret owner to challenge the enforceability of trade secrets. Therefore, one or both parties may perceive some substantive disadvantage to their case if discovery is curtailed in arbitration.

Parties may resist relinquishing another procedural safeguard of litigation: the broad right to appeal an adverse decision on the merits. A party has limited rights to an appeal the merits of an adverse arbitration award. An arbitration award can only be vacated for egregious procedural defects, such as fraud in the proceedings or misconduct by an arbitrator.⁴³ In the high stakes intellectual property cases, some clients want to preserve every option to overturn an adverse decision on appeal.

If an arbitration is structured to provide all of the discovery and procedural safeguards available in court, arbitration loses its advantage of less time, cost and complexity. In fact, arbitration can cost more than a lawsuit. A court charges a filing fee of a few hundred dollars for a lawsuit, and the government bears the costs of the judge, jurors and court administrators. In contrast, the parties must pay the arbitrator's expenses and the costs of administering the arbitration. These expenses can be substantial, totaling over \$100,000 in a complex, protracted arbitration. Some business people and lawyers have had negative experiences with arbitration of IP disputes, and they are skeptical that arbitration will actually save any time or money.⁴⁴

The bottom line is that many IP disputes are considered too important to give up any opportunity to prevail. A company's important business segment, or the entire company, could be in jeopardy if it loses the dispute. In such circumstances, winning at all costs is the only option.

⁴³ See, e.g., 9 U.S.C. § 10 (1970).

⁴⁴ See e.g., November 2006 *ABA Journal*, pp. 19-20.

C. Mediation

Sometimes a mediator is used to help the parties reach a settlement. The parties and mediator have a great deal of flexibility in the structure of the mediation process. The mediator may request a written statement from each party on its position on the issues, and the range of acceptable outcomes from the mediation. These mediation statements may or may not be shared with the other party – it depends on the wishes of the parties.

An essential part of any mediation is a face-to-face meeting with the mediator and a representative from each party. The party representative usually must come have the requisite authority to reach a settlement. Counsel for each party usually attends the meeting. The mediator may begin the meeting by sharing his or her candid views of the issues and the likely outcome in court. Alternatively, the mediator may ask each party to make a presentation on its view of the issues. The other party may be present so that it can see how the other side views and presents its case. As another alternative, the mediator may begin by meeting privately with one of the parties, and then engaging in shuttle diplomacy.

At some point in almost every mediation, the mediator resorts to shuttle diplomacy. In meeting separately with each side, the mediator tries to move them closer to the other side's position. The mediator often helps each side better understand and recognize the weaknesses in their case and the strengths in the other side's case. The mediator also may suggest new and creative ways to bring the parties to a settlement.

Mediation is not easy because it is a non-coercive process. The mediator does not decide anything, and cannot force either side to do something that it does not want to do. To work, mediation requires a skilled mediator, and all parties must be open-minded, flexible and truly desirous of reaching a settlement. Each side typically leaves the mediation compromising more than they expected at the outset.

Many courts, both federal and state, provide mediations programs to litigants. In some cases, the judges strongly encourage the parties to make a good-faith effort to settle through mediation. Most litigants do not want to offend the judge presiding over their case and, therefore, parties rarely refuse to participate in a court-sponsored mediation. Sometimes the trial judge will preside over a pre-trial settlement conference, which is conducted like a mediation. Other times, the trial judge will refer the case to a magistrate judge to conduct a mediation. Some courts have a group of local lawyers trained as mediators. One advantage of court-sponsored mediations is that the parties do not have to pay for the mediator's time. Judges and magistrate judges are paid by the government. The lawyers in a court-annexed mediation usually volunteer all or part of a day at no charge to the parties.

Parties also may arrange for a mediation on their own, and hire a professional mediator. Independent service providers like the WIPO Arbitration and Mediation Center and JAMS (www.jamsadr.com) offer an extensive roster of eminent attorneys and retired judges who are skilled mediators. The parties will have to pay for the mediator's time and

expenses, which is often several thousand dollars per day. However, the parties also have more control over the choice of the mediator and the timing of the mediation.

Mediation has many advantages. When it works, the parties can resolve their disputes faster, more economically and with more control over the outcome. On the other hand, when it does not work, mediation may add more time and expense to reaching a final resolution of the dispute. On balance, the advantages of mediating commercial disputes is receiving increased acceptance in corporate America.⁴⁵

D. Conclusion

Arbitration and mediation are well-accepted forms of dispute resolution processes in the United States. They are frequently employed to resolve intellectual property disputes. Courts in the U.S. are strong supporters of arbitration and mediation. If the parties agree to arbitrate or mediate, a court will not allow them to easily escape from that agreement. Consequently, parties are well-advised to thoroughly consider the countervailing advantages and disadvantages of arbitration and mediation before they commit to these alternative dispute resolution processes for their IP disputes.

⁴⁵ See e.g., November 2006 *ABA Journal*, pp. 19-20.