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Covenants, Conditions and Copyright License Agreements

Rhett Barney

Copyright licensors who want infringement damages for a licensee’s violation of the copyright license need to carefully distinguish covenants from conditions in their license agreements. Such is the teaching of the Ninth Circuit in *MDY Industries, LLC v. Blizzard Entertainment, Inc.*, [629 F.3d 928](#) (9th Cir. 2011).

The case involved Blizzard Entertainment’s World of Warcraft software, which players’ computers necessarily copy into RAM every time they play. Accordingly, every use potentially involves copying if the copy is sufficiently fixed, an act that potentially violates Blizzard’s copyrights because users of the software are considered licensees and not owners. Blizzard argued that MDY’s creation of a ‘bot’ that players used to automate play during the early levels of the game violated the Terms of Use, thus ending their limited license. As such, Blizzard argued that each time these players accessed the game thereafter, Blizzard’s copyrights were infringed and MDY’s actions constituted secondary infringement. The Ninth Circuit agreed that players’ use of the bot violated the Terms of Use, but concluded that this did not give rise to claims for copyright infringement.

Noting the common-law distinction between covenant (a contractual promise) and a condition (an act or event that triggers a duty or a right), and relying on the equitable principle that ambiguous terms should be interpreted as covenants rather than conditions, the court concluded that the prohibitions against bots in the

Terms of Use were merely covenants, not “copyright-enforceable conditions.” Furthermore, the court stated that none of the exclusive statutory rights triggering copyright infringement were violated, and that the “condition” unique to copyright infringement could not have occurred.

The distinction is important for purposes of damages. Damages resulting from a breach of a covenant are computed under traditional contract law. In contrast, copyright violations of registered works can yield either actual damages, or alternatively, statutory damages ranging between \$750 and \$150,000 per infringing work. See [17 U.S.C. § 504\(c\)\(1\)-\(2\)](#).

Accordingly, when drafting copyright license agreements and other limits on the licensee’s use, counsel for licensors should phrase all limiting terms as conditions and should keep in mind that copyright damages for a breach will not be available unless the activities following the breach violate an exclusive statutory right. Language such as the following should work.

The license granted to [Licensee] in this Agreement is expressly conditioned on [Licensee’s] compliance with all the limitations and terms of this Agreement; the license terminates immediately upon any violation by [Licensee] of the limitations or terms of this Agreement.

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Binding Guarantors to Terms in the Note

Stephen L. Sepinuck

You represent a lender that has made a loan to a corporation or LLC, guaranteed by some or all of the owners of the borrower. The borrower has defaulted and the lender wants to bring one action against the borrower and all the guarantors, so as to minimize

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litigation costs and avoid the possibility of conflicting rulings. The loan agreement contains a choice-of-law clause and a choice-of-forum clause. Are the guarantors bound by such clauses? That is, have the guarantors agreed to the law and the forum designated in the loan agreements? The answer is an emphatic “maybe.” Several recent cases suggest that the guarantors will not be bound to such terms merely because they have guaranteed the debt. Instead, the answer may depend on how the guaranty agreement is phrased.

For example, in *Freestone Capital Partners L.P. v. MKA Real Estate Opportunity Fund I, LLC*, [230 P.3d 625](#) (Wash. Ct. App. 2010), the court ruled that a choice-of-law clause in some notes was not relevant to the lender’s action on subjoined guaranties, which lacked such a clause. Instead, the court ruled that the governing law was to be determined pursuant to general conflicts-of-law principles, and the court remanded the case to the trial court to apply those principles. The choice of law could, of course, significantly affect the lender’s rights because state law on guaranties can vary in important ways. *See, e.g., Wash. Rev. Code § 62A.9A-602* (a non-uniform version of U.C.C. § 9-602 that allows a secondary obligor to waive rights that the uniform text does not).

It is worth noting that court regarded other clauses in the note as binding on the guarantors. Specifically, although there was no attorney’s fee clause in the guaranties, there was such a clause in the guaranteed notes and therefore the guarantors were liable for fees incurred in attempting to collect not merely from the borrowers, but also from the guarantors themselves. In short, the guarantors had promised to pay the guaranteed obligation, which included attorney’s fees, but the guarantors had not promised to be bound by other terms in the note.

The court in *Jetstream of Houston, Inc. v. Aqua Pro Inc.*, [2010 WL 669458](#) (N.D. Ill. 2010), applied much the same principle. The court ruled that a forum-selection clause in some promissory notes did not bind guarantors, largely because the guaranties promised *payment* of guaranteed debt, not *performance* of all contractual obligations of the debtor. The court bolstered its conclusion by noting that the guaranties included the same choice-of-law provision as the guaranteed notes but lacked the venue and jurisdiction provisions, suggesting that the parties had purposefully distinguished the enforcement procedure under the notes from the enforcement procedure under the guaranty.

The court’s ruling seems correct even though its reasoning is questionable. A guaranty of *payment* does not necessarily bind the guarantors to a choice-of-law or choice-of-forum clause in the loan agreement. But it is not clear that a guaranty of *performance* would or should be treated differently. After all, a choice of law is not something that either party *performs*. And while a choice-of-forum could be viewed as a promise by each party to litigate in a particular jurisdiction, by guaranteeing performance the guarantor is promising to perform the principal obligor’s duty, not necessarily accepting a similar duty for itself. Thus, the guarantor might be promising to litigate issues about the borrower’s liability in the chosen forum, but not agreeing to litigate there issues relating to the guarantor’s own liability or defenses.

Certainly, there is some contrary authority that is willing to treat a guarantor as bound by a choice-of-law or choice-of-forum clause in the loan agreement. *See, e.g., Regions Bank v. Weber*, [2010 WL 5121074](#) (La. Ct. App. 2010) (even though guaranty agreement contained no arbitration clause, creditor had to arbitrate action against guarantor because the guaranteed promissory note contained an arbitration clause). Nevertheless, lawyers drafting guaranty agreements would be well advised to assume that appropriate language is needed to make the guarantors subject to the forum and law selected in the loan agreement. That language could simply be copied from the loan agreement into the guaranty (such as the choice-of-law clause below) or could be a cross-referential statement (such as the choice-of-forum clause below).

Choice of Law

The law of the State of [] governs this Agreement [and all aspects of the relationship of the parties hereto].

Choice of Forum

All litigation arising out of or relating to this Agreement [or the relationship of the parties hereto] must take place in the forum designated in the [Loan Agreement] as the place for litigation arising out of or relating to the [Loan Agreement].

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What Are the Fundamental Attributes of Arbitration?

Linda J. Rusch

The U.S. Supreme Court's recent decision in *AT&T Mobility, LLC v. Concepcion*, [131 S. Ct. 1740](#) (2011) raises some interesting questions regarding the ability to insulate agreements to arbitrate from attack on grounds that would invalidate clauses in contracts without an arbitration clause. At issue in the case was whether the arbitration clause in AT & T Mobility's contract which prohibited class action or representative proceedings in arbitration was unconscionable under the California Supreme Court's ruling in *Discover Bank v. Superior Court*, [113 P.3d 1100](#) (Cal. 2005). The California Supreme Court had found unconscionable contract clauses that prohibited class action waivers in consumer adhesion contracts that predictably would involve small damage amounts and the clauses were part of a scheme to prevent the non-consumer from having responsibility for its fraudulent conduct or willful injury to another's person or property. [113 P.3d at 1110](#).

In the *AT & T Mobility* case, both the majority and dissent seemed to agree that the California ruling finding class action waivers unconscionable applied equally to class action waivers in contracts with arbitration clauses and those contracts without arbitration clauses. The majority found, however, that equality did not matter. Rather, interpreting section 2 of the Federal Arbitration Act (FAA) ([9 U.S.C. § 2](#)) which provides that arbitration clauses are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," the majority reasoned as follows:

1. Federal policy was to promote enforcement of arbitration clauses that were part of the agreement of the parties.
2. The FAA was designed to put arbitration clauses on an equal footing with other contract clauses.
3. Section 2 of the FAA should not be interpreted to eviscerate the fundamental attributes of arbitration proceedings.
4. Class action proceedings are incompatible with the fundamental attributes of arbitration proceedings.

5. Thus, the California rule was inconsistent with the FAA, and thus class action waivers in contracts with arbitration agreements were enforceable.

Justice Thomas, who joined the majority opinion, but offered his own concurring opinion, focused on lower courts' interpretation of the FAA [§ 2](#) that the saving clause should be confined to contract doctrines that implicated the concept of agreement, such as fraud and duress. He opined that because the California rule was not so focused, it was incompatible with the FAA. The dissent focused on the equality of treatment (contracts with arbitration clauses and contracts without arbitration clauses treated equally) and the troubling question of how the majority decided that class actions were incompatible with arbitration proceedings.

Where does this leave the enforceability of arbitration clauses? What are the fundamental attributes of arbitration proceedings? Consider the following issues that may arise in drafting arbitration clauses.

1. Attorney fee shifting provisions. If a state has a public policy of reciprocity in which a unilateral attorney fee shifting clause is converted to a bilateral clause, *see e.g.*, [Cal. Civ. Code § 1717](#), and that policy applies to all contracts, is that statute antithetical to some fundamental aspect of arbitration proceedings so that the state's statute would be applicable only to contracts without arbitration clauses?

2. Remedy caps. If a state has a public policy that all consumer contracts must have an adequate remedy for breach of contract, and the arbitration clause caps damages at less than that amount, is that cap an aspect of arbitration proceedings that is so fundamental that the state's public policy would be applicable only to contracts without arbitration clauses?

3. Venue. If a state has a public policy that all consumer contract dispute resolution proceedings (litigation and non-litigation) must be brought in the state and county of the consumer's billing address and the arbitration clause provides for a different venue, is that inconsistent with an aspect of arbitration that is fundamental and so would be applicable only to contracts without arbitration clauses?

Now consider a bigger picture. Assume a state legislature created a statute that said all arbitration in consumer contracts of under \$1,000 must comply with a number of consumer protection policies, including the manner of selecting arbitrators, how costs are split,

and the manner of arbitration. The majority opinion in *AT & T Mobility* certainly indicated that proscribing how the arbitration must be conducted would be a suspect state policy that could undermine the fundamental attributes of arbitration proceedings, and thus be incompatible with the FAA. But assume an arbitration clause selects a venue (outside the country), process (in person only), and cost structure (e.g. filing fee, damage caps, and attorney fee shifting) that are all designed to prevent claims for breach of the agreement. Has the *AT & T Mobility* case insulated that sort of clause from all attack unless there is proof of an individual problem in the consent to the arbitration agreement, in effect overruling cases such as *Brower v. Gateway 2000, Inc.*, [676 N.Y.S.2d 569](#) (App. Div. 1998)?

Given the analysis in *AT & T Mobility*, contract drafters will need to identify the “fundamental attributes of arbitration” and determine whether the arbitration clause as drafted adheres to those attributes. Unfortunately the case gives no guidance on how to make that identification, including the extent to which arbitration rule sets such as those promulgated by the American Arbitration Association will influence that analysis.

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Recent Cases

SECURED TRANSACTIONS

In re Jojo's 10 Restaurant, LLC,
[2011 WL 1984529](#) (Bankr. D. Mass. 2011)

No authenticated security agreement existed even though asset purchase agreement provided that the buyer’s obligation “shall be secured by a standard form UCC Security Agreement,” and the filed financing statement described the collateral. The asset purchase agreement lacked granting language and the financing statement was not signed by the debtor.

Maple Trade Fin., Inc. v. Lansing Trade Group, LLC,
[2011 WL 1060961](#) (D. Kan. 2011)

Account debtor that signed debtor’s invoices acknowledging receipt of the goods was not estopped from denying receipt in action brought by factor that had loaned against the invoices in reliance on the account debtor’s acknowledgment. Unless it agrees otherwise, an account debtor is entitled to raise defenses arising under the contract and estoppel is not an agreement to waive those rights. Even if estoppel were available, factor would not be entitled to summary judgment because there was evidence indicating that it had not followed its own procedures.

In re Hobart,
[2011 WL 1980332](#) (Bankr. D. Id. 2011)

Security agreement governed by Oregon law and providing that “[a]ll collateral securing one loan will secure all your other obligations . . . , including all existing and future loan obligations” was sufficient to make each financed vehicle secure the debt for each of the other vehicles.

BANKRUPTCY MATTERS

In re Avondale Gateway Center Entitlement, LLC,
[2011 WL 1376997](#) (D. Ariz. 2011)

Intercreditor agreement that “subrogated” senior lender to junior lender “with respect to [junior lender’s] claims against Borrower” was sufficient to give the senior lender the right to vote junior lender’s claim in the debtor’s reorganization proceeding.

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