CHAMBER OF NATIONAL AND INTERNATIONAL ARBITRATION OF MILAN

Final award in case no. 1398 of 18 March 1999

Parties:	Claimant: Licensee (Italy) Defendant: Licensor (Italy)
Place of arbitration:	Milan, Italy
Published in:	Unpublished. Original in Italian
Subject matters:	– patent – extra-contractual liability – cession of contract

Facts

By a license agreement concluded in 1991, A, an Italian company belonging to the multinational M-Group, granted B the non-exclusive license to market the pharmaceutical products Y, containing "compound Z" in Italy. B undertook to purchase compound Z from M, a company belonging to the M-Group, and to have the final product manufactured by another company of the M-Group. The contract contained a clause providing for arbitration by three arbitrators under the Rules of the Chamber of National and International Arbitration of Milan and for the application of Italian law.

In August 1993, A transferred all activities relating to the promotion, distribution and sale of pharmaceutical products, including Y products, to M-Italy, a company belonging the M-Group.

The license agreement indicated that A was the "owner of all rights, title and interest in the pharmaceutical compound known as Z" (English original), that M was the "holder" of the license to manufacture, use and sell compound Z, and that yet another company of the M-Group was the "holder" of the sub-license to manufacture and sell the pharmaceutical products Y.

After an initial period, B attempted to renegotiate the financial terms of the license agreement, maintaining that A had fraudulently led it to believe, at the time of concluding the license agreement, that compound Z was patented. B claimed that it was facing competition by other companies, which were freely using compound Z in their products as it appeared that Z was not patented. Negotiations failed, and B commenced arbitration proceedings before the Milan Chamber of Arbitration in May 1998.

By a majority decision, the panel of three arbitrators held that there was no proof that A had fraudulently led B to believe that A held a patent on compound Z.

Excerpt

I. JURISDICTION

[1] "A objects to the jurisdiction of the arbitrators. It maintains that B's claim is based on Art. 1440 CC (*dolo incidente*)[1] and that *dolo incidente* leads to a liability for damages, that is, to an extra-contractual liability that does not fall within the scope of the arbitration clause.

[2] "This objection notwithstanding, the arbitrators deem that they have jurisdiction to hear a dispute under Art. 1440 CC. This article provides for damages where a party's freedom to enter into a contract is affected, and any case in which contractual freedom is affected falls within the jurisdiction of the arbitrator hearing a dispute based on the contract. Also, the present arbitration clause covers 'all disputes arising in connection with this agreement' [English original]. A dispute concerning pre-contractual liability is a dispute in connection with the agreement.

[3] "A further objects to the jurisdiction of the arbitrators on a second ground. It maintains that the contracting party to the agreement is [now M-Italy], to which A transferred all activities relating to the promotion, distribution and sale of pharmaceutical products, and which is not a party to the arbitration.

[4] "[The arbitrators remark, however], that, first, the parties disagree on whether this transferral of activities concerns the relationship at issue; second, it is disputed whether it may be opposed to B.

1. Art. 1440 of the Italian Civil Code (CC) reads:

"Where deceit is not such as to cause the party to consent [to a contract], the contract is valid even if it would have been concluded on different conditions, had there been no deceit; the deceiving party is liable for damages."

[5] "The arbitrators examine this issue and hold that they may hear the dispute between the parties and that A is the defendant in this arbitration, on the following ground. The cession of a contract may be opposed to a third contracting party only where the agreement between the party ceding the contract and the party to whom the contract is ceded is complemented by a further element, be it notification, registration, third party's knowledge [of the cession], etc. In the case at issue nothing proves that there was such a complementary element. A claims that B knew of the transferral [of A's activities] to M-Italy, as it always addressed itself to M when this legal dispute arose. However, the fact that B contacted M proves nothing at all. The [license] agreement at issue provides that B enter into a supply contract with M; hence, as far as this relationship was concerned, B could only address itself to M. However, when a dispute arose in relation to B's consent to the [license] agreement, B could only address itself to the party with which it concluded the 1991 license agreement."
(....)

II. FRAUD

[6] "When dealing with the main issue of this case, the arbitrators ask themselves whether it is proven that fraud affected B's consent at the time of concluding the agreement. The arbitrators note that fraud consists of two elements: the deceitful behaviour of one party and the error of the other party.
[7] "Having thus defined fraud, the arbitrators ask themselves a first question: Is it proven that B was mistaken, when concluding the [license] agreement, because it incorrectly believed that compound Z was a patented product that could not be manufactured by any company other than the M-Group companies? In order to reply to this question it should be noted that agreements are concluded concerning both patented products and non-patented products that have a monopolistic, predominant or strong position in the marketplace. In order to ascertain whether parties have a patented or non-patented product in mind when concluding a contract, we must first consider the text of the contract itself. In the present case, the agreement does not mention a patent on compound Z, notwithstanding the alleged (by B) great relevance that a patent would have had in the relationship.
[8] "A patent is, by its nature, short-lived. The value of a patent-related right is proportional to the patent's residual validity. Thus, a party negotiating such right will request that the contract mention the patent's date. In the present case, the license was non-exclusive. The licensor not having an exclusive right in the intellectual property concerned is of no vital importance to the non-

exclusive licensee. The licensor's lack of an exclusive right only means that the licensee may have to face the competition of other parties, and a non-exclusive licensee clearly accepts such a risk.

[9] "B relies on several elements in support of its claim that it was deceived: (a) Art. 1(f) of the agreement mentions that the M-Group owns exclusive rights; (b) Art. 5(a) requires B to clearly mention in all relevant circumstances that it is a licensee of A; (c) Art. 6(a) requires B to take over the authorization issued by the Ministry of Health for marketing Z-based products to the previous licensee, at the price of LIT 1,400,000,000; (d) the agreement requires B to purchase compound Z only from the M-Group and to have the final product manufactured by another company of the group; (e) the qualifying element of a pharmaceutical product is its novel and innovative character, which allegedly corresponds with its being patented and thus exclusive; (f) in its contacts with the Ministry of Health in 1987, [the previous licensee] affirmed that the M-Group had requested a patent to the Patent Office in 1978; according to a document submitted by B, a patent was in fact issued in 1988 ...; (g) M sought to purchase the product of [another company) which had become a competitor. A opposes two considerations to the above: (h) B's offer ... (from which the agreement at issue directly ensued) mentions compound Z but does not mention that the M-Group owns Z; (i) the supply agreement between M and B, which was concluded in compliance with the disputed agreement, mentions compound Z but does not mention a patent thereon. (....)

[10] "After careful consideration of the merit and impact of the above observations, the majority of the arbitral tribunal holds as follows.

[11] "(a) Art. 1(f) of the agreement provides ...:

> 'B shall have no further rights on the products other than those rights granted by the present agreement and all ownership rights on the products and the A know-how shall always belong to M and A.'

The products referred to are the Y products, not compound Z (see clause 1(a), according to which the products shall be marketed under the brand name Y and shall contain a certain quantity of compound Z). 'Ownership' is here a generic legal term meaning 'belonging to', as 'ownership' refers to both products and know-how, which is definitely not the same as a patent.

[12] "The majority of the arbitrators deems that if a party enters into an agreement based on a patent it holds, it will mention in the agreement that it holds that patent (and will indicate the date of the patent). It will not simply say that it is the owner of all rights, title and interests. By agreeing to this

formulation, therefore, B did not indicate that it believed that A held a patent on compound Z.

[13] "According to Art. 5(a), B shall indicate on all packaging of Y products ... that they are manufactured on a license granted by A. This clause would be appropriate and functional in contracts concerning products based on both a patented and a non-patented compound. It does not prove that B believed that [compound Z] was patented.

[14] "According to Art. 6(a), B shall purchase the Ministry of Health authorization from [the previous licensee] for LIT 1,400,000,000. B maintains that it would have had no reason to purchase the authorization, had it known that compound Z was not patented, as anyone may request a marketing authorization from the Ministry for a non-patented product.

[15] "The majority of the panel holds that, although it does not appear from the file of the case why B accepted to purchase the authorization from [the previous licensee], there were several reasons to do so, as it appears from the circumstances of the case. Payment to [the previous licensee] was an indirect manner of terminating the practical effects of the license granted by A to [the previous licensee]. Contractual negotiations put the burden of this payment on B, rather than on A, as one of B's obligations. Transferring the authorization was quicker than requesting a new one. B's acceptance of this clause does not prove that B believed that compound Z was patented.

[16] "According to the agreement, B was to purchase compound Z from and to have Y products manufactured by companies of the M-Group. This clause is due to the M-Group's wish to maintain control of operations relating to Z and Y. Both the holder of a patent and a company with a predominant position in a certain field would wish the same.

[17] "In the pharmaceutical sector, the qualifying element of a product is its novel and innovative character, combined with the exclusive use thereof. This is certainly true, but there is also a market for non-patented products. The undoubted advantage of holding a patent does not support the conclusion that an agreement ... for marketing the Y products could be concluded only by somebody who mistakenly believed that compound Z was patented. On the contrary, the existence of a patent was less relevant since the license was non-exclusive.

[18] "In its contacts with the Ministry of Health in 1987, [the previous licensee] affirmed that a company of the M-Group had requested a patent on compound Z; according to a document produced by B, a patent was in fact granted in 1988. The majority of the panel holds that the possible existence of a patent does not support, rather contradicts B's fraud thesis, on which its claim under Art. 1440 CC is based. If a patent existed and the agreement did not mention it, B may draw no conclusions from its existence.

[19] "M sought to purchase the product of a competitor, that contained compound Z. The majority of the panel holds that this only proves that M wished to dominate the market by silencing competition. This fact bears no connection to the questions submitted to the arbitrators.

[20] "B's offer ..., on which the disputed agreement is based, refers to the Y products as to 'products under your brand name' and 'your products', whereas it mentions compound Z but does not mention who owns it (see: 'your products containing compound Z'). Also, the supply agreement between M and B, which B concluded in compliance with the disputed agreement, mentions Z but makes no reference to a patent thereon. The majority of the panel deems that B's formulation shows that both parties were not interested in the juridical status of compound Z. This is normal considering that this was a non-exclusive license.

[21] "The above considerations lead the majority of the panel to conclude that it does not appear from the file of the case that B mistakenly believed, at the time of signing the contract, that compound Z was patented, or that any company of the M-Group meant in any way that B would have the exclusive use of Z.

(....)

[22] "B alternatively claims [in a statement] that A did not perform under the agreement as it failed to protect its patent [on compound Z] and to hinder illicit competition against B after having concluded the [license] agreement. For the reasons outlined above, the majority of the panel holds that the parties did not rely on a patent and did not undertake any obligations relating thereto. This claim must thus be denied. We should add that B's claim that compound Z was patented ... is logically at odds with its initial claim that the agreement was affected by fraud because [A led B to believe] that Z was patented."