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The Essential Role of Courts for Supporting Innovation

Erin O'Hara O'Connor* & Christopher R. Drahozal**

I. Introduction

In most commercial exchange, formal legal principles and court systems play a surprisingly small role for transacting parties. Stuart Macaulay interviewed a group of Wisconsin business people in the 1960s and found that they had little regard for the prospect that lawyers could add value to a transaction.¹ To the contrary, interviewees complained that lawyers often got in the way of their business dealings, and that they preferred to do business by handshake rather than by contract.² When contracts were drafted at the formation of their business relationships, they were typically tossed into a drawer or file and never again consulted. These business people typically resolved their conflicts through extralegal means, without regard to the terms of their contract and without resort to formal dispute resolution processes.³

Even when contracting parties do end up involved in disputes they cannot resolve on their own, some claim that they are much more likely to resort to informal dispute resolution mechanisms, including mediation and arbitration, than they are to resort to courts. For example, Lisa Bernstein has documented the extensive use of arbitration by firms in the commodities trade, by which they opt out of the court system altogether and enforce trade rules by reputational sanctions rather than government force.⁴

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1. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 55 (1963).

2. *Id.* at 58.

3. *Id.* at 61.

4. See generally, e.g., Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996) (examining the National Grain and Feed Association as a private legal system); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) (examining the use of private legal systems in the cotton industry).

Such a reliance on private dispute resolution has led some to suggest that courts have become effectively irrelevant to commercial law.⁵

It turns out that innovation is distinctly different, however. According to recent studies, parties to innovative contracts and those operating in innovative environments rely much more heavily on lawyers and contract documents than do their counterparts in non-innovative environments. For example, Iva Bozovic and Gillian Hadfield recently conducted a follow-on study to McCauley's to glean whether today's business people share the same contempt for lawyers, contracts, and courts that McCauley observed in 1963.⁶ They found that California business people operating in firms that conducted business deemed non-innovative shared the same attitudes that McCauley observed.⁷ But those operating in firms involved in innovation reported very different attitudes.⁸ These business people regularly consulted with lawyers in putting together their deals, and they routinely wanted a formal written document to memorialize their agreements.⁹ Moreover, the contract would regularly be consulted, at least privately, when conflict emerged.¹⁰

Bozovic and Hadfield explain the difference between innovating and non-innovating firms as resulting from differences in the thickness of business norms. In more static business environments, norms of acceptable commercial conduct develop to guide the behavior of market actors.¹¹ When conflict arises in these commercial contexts, the norms become the reference point for the parties, making formal legal institutions largely irrelevant at best and counterproductive at worst.¹² By contrast, in innovative contexts, where a market, good, or service is just emerging,

5. Of course, some authors have suggested that sophisticated parties prefer courts to arbitration, as shown by the limited use of arbitration clauses in corporate transactional contracts. Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 335 (2007); see also Jens Dammann & Henry Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 31 (2008) ("In practice, arbitration does not seem to compete strongly with well-functioning public courts."). The two positions can be reconciled, it turns out, based on the types of contracts examined. See Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433, 457-67 (2010) (noting that arbitration clauses are most prevalent in ordinary contracts between businesses but are less likely to be found in contracts outside of the ordinary course of business, e.g., loan commitments and merger agreements).

6. Iva Bozovic & Gillian K. Hadfield, *Scaffolding: Using Formal Contracts to Build Informal Relations in Support of Innovation 6* (Aug. 26, 2013) (unpublished manuscript), available at <http://works.bepress.com/cgi/viewcontent.cgi?article=1055&context=ghadfield>.

7. *Id.* at 9.

8. *Id.* at 10.

9. *Id.* at 16-17.

10. *Id.* at 22.

11. *Id.* at 5.

12. *Id.* at 15.

shared business norms typically have not yet developed.¹³ The parties therefore use lawyers and contracts as norm substitutes.¹⁴

Notwithstanding this reliance on legal documents, however, Bozovic and Hadfield's interviewees consistently expressed a strong commitment to staying out of court.¹⁵ The documents might guide their transacting behavior, but disputes were to be settled privately.¹⁶ This last finding is consistent with common intuitions about commercial-party avoidance of courts. Scholars have documented a number of private mechanisms that parties commonly use for avoiding or resolving contract disputes, including expected future gains and the use of prepayment, hostage taking, collateral, reputational sanctions, and mediation, among others.¹⁷ In most cases, these mechanisms can be cheaper, quicker, and more effective than courts, and many of them are more likely to fulfill the goal of preserving the future benefits of the parties' relationship.¹⁸ Not surprisingly, then, they show up as common features of commercial contracts and trade-association support systems.¹⁹

Even though innovating firms rely on lawyers and contracts, the terms that they negotiate often cannot be enforced in a court of law. In their work on contracting for innovation, Gilson, Sabel, and Scott emphasize the fact that most of the critical terms of contracting parties' relationships cannot be specified in contracts that contemplate the development of innovative products and services.²⁰ In the context of joint venture or innovative outsourcing contracts, for example, the parties are contracting for the production of something that does not yet exist. In that environment, it is impossible to specify price and quantity. Indeed, parties cannot typically specify either the end result or the parties' duties in developing the

13. *Id.* at 5.

14. *Id.* at 6–7.

15. *Id.* at 18–20.

16. *Id.* at 16–17.

17. *See, e.g., id.* at 19–20 (documenting expected future gain and reputational sanctions as performance assurances); Howell E. Jackson, *Regulation in a Multisectoral Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319, 341 (1999) (noting prepayment and security as methods for insuring against nonperformance); Thomas J. Stipanowich, *Arbitration: The "New Litigation,"* 2010 U. ILL. L. REV. 1, 58 (citing mediation as an alternative mechanism to resolve disputes); Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 519–20 (1983) (arguing that hostage taking is "widely used to effect credible commitments").

18. Stipanowich, *supra* note 17, at 58.

19. *See, e.g.,* Nancy A. Welsh & Andrea Kupfer Schneider, *The Thoughtful Integration of Mediation into Bilateral Investment Treaty Arbitration*, 18 HARV. NEGOT. L. REV. 71, 120 (2013) (stating that commercial contracts in the United States are increasingly "provid[ing] for mediation as one step of several in a dispute resolution clause").

20. Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Forms*, 88 N.Y.U. L. REV. 170, 194–96 (2013).

innovation.²¹ Thus, many of the critical terms in these contracts are necessarily fatally vague, without an effective remedy, or both, at least from a legal standpoint.²²

When parties do have disputes over concrete terms that need outside enforcement, they often seek to have those disputes resolved in arbitration rather than in courts.²³ Arbitration can be quicker and cheaper than resorting to courts,²⁴ and arbitration enables the parties to choose a decision maker with greater expertise in the subject matter of the dispute than is possible with judges.²⁵ Because of these and other benefits, some commentators have asserted that arbitration is a superior venue in which to resolve intellectual property (IP) disputes.²⁶

Given party attitude toward courts and the ready availability of substitute private mechanisms for dispute resolution, one might be surprised to ever see contracting parties insisting on a right to file suits in court. This should be especially true at the drafting stage of a contract because focusing on possible future legal battles can signal to the other party an anticipation of waging such battles. Furthermore, given the effective unenforceability of the essential terms of contracts for innovation, the last thing innovating parties should be focused on is preserving rights to file lawsuits.

Yet a significant and growing number of contracting parties are demanding precisely this right: a right to go to court for the resolution of particular claims and to obtain particular remedies. In empirical studies that we have conducted jointly and separately, we have found parties that incorporate arbitration clauses into their agreements commonly carve out specific rights to proceed in court.²⁷ Moreover, the vast majority of these

21. *Id.* at 194.

22. *Id.* at 199.

23. *E.g.*, Matthew C. Jennejohn, *Contract Adjudication in a Collaborative Economy*, 5 VA. L. & BUS. REV. 173, 197 (2010) (“[Parties to collaborative agreements] resort to arbitration far more often than commercial parties resolving disputes relating to more traditional types of commercial contracts.”).

24. Drahozal & Ware, *supra* note 5, at 451.

25. *See, e.g.*, Richard W. Naimark & Stephanie E. Keer, *International Private Commercial Arbitration: Expectations and Perceptions of Attorneys and Business People: A Forced-Rank Analysis*, 30 INT’L BUS. LAW. 203, 203–04 (2002) (identifying arbitrator expertise as a factor in choosing arbitration over other forms of adjudication).

26. *E.g.*, Anne St. Martin & J. Derek Mason, *Arbitration: A Quick and Effective Means for Patent Dispute Resolution*, 46 LES NOUVELLES 269, 278 (2011); Richard H. Saylor, *The Case for Arbitrating Intellectual Property Licensing Disputes*, DISP. RESOL. J., Feb.–Apr. 2005, at 62, 67.

27. Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?*, 37 HOFSTRA L. REV. 71, 113–14 (2008) [hereinafter Drahozal & Wittrock, *Flight from Arbitration*]; Christopher R. Drahozal & Erin O’Hara O’Connor, *Unbundling Procedure*, 66 FLA. L. REV. (forthcoming 2014) (manuscript at 3) (on file with author) [hereinafter Drahozal & O’Hara O’Connor, *Unbundling Procedure*]; Christopher R. Drahozal, “Unfair” Arbitration Clauses, 2001 U. ILL. L. REV. 695, 762–64 [hereinafter Drahozal, “Unfair” Arbitration Clauses]; Erin O’Hara O’Connor et al., *Customizing Employment Arbitration*, 98 IOWA L. REV. 133, 137 (2012) [hereinafter O’Hara O’Connor et al., *Customizing Employment Arbitration*]; Randall Thomas,



contractual provisions preserve rights to proceed in court in order to protect information and innovation.²⁸ Specifically, parties are opting to have claims related to their noncompete, confidentiality, and nonsolicitation clauses, as well as their trademark, copyright, and patent rights and trade secrets resolved in courts. Alternatively, parties reserve a right to proceed to court to obtain injunctive relief, the critical remedy for the protection of these rights.²⁹

These contracts illustrate the weaknesses of self-help remedies and the relative shortcomings of arbitration in the context of innovation. In fact, when these carve-outs are combined with contracts that do not call for arbitration in the first place, sometimes as much as 80%–90% of contracts studied end up opting for courts rather than arbitration in these contexts, and the choices are made with increasing frequency over time. Notwithstanding private contracts and largely unenforceable terms, parties increasingly demand courts over arbitration for the protection of their intellectual property rights.

This Article explores party use of contract terms that express a preference for courts for the enforcement of rights surrounding innovation. Part II briefly explains the advantages of courts over arbitration in protecting innovation. Part III describes the empirical findings that support our assertion that private parties demand courts for the protection of their innovation. Part IV then explores the implications of our findings for the applicable rules applied by courts. Notwithstanding scholarly assertions that courts are becoming increasingly irrelevant for the resolution of commercial disputes,³⁰ they likely will continue to play an essential role in supporting party rights to innovation.

II. Courts and Innovation

As demonstrated in Part III, parties who agree to resolve disputes through arbitration commonly carve out a right to use courts instead for the enforcement of rights that protect information and innovation.³¹ When we have presented these empirical results to alternative dispute resolution experts, the use of carve-outs from arbitration clauses has surprised many, including arbitration practitioners, who have told us that they would advise their clients against using them. The problem, as described by practitioners, is that carve-outs create a risk that the parties will be stuck simultaneously

Erin O'Hara & Kenneth Martin, *Arbitration Clauses in CEO Employment Contracts: An Empirical and Theoretical Analysis*, 63 VAND. L. REV. 959, 999–1000 (2010) [hereinafter Thomas et al., *CEO Employment Contracts*].

28. See *infra* text accompanying notes 74–89.

29. See *infra* Table 1.

30. See *supra* text accompanying notes 1–6.

31. See *infra* text accompanying notes 74–89.

litigating their dispute in both court and arbitration, with potential legal battles over the jurisdictional dividing line between the two.³² Despite these potential objections, the empirical results suggest that transactional attorneys apparently conclude that this risk of bifurcated claims is offset by the benefits from court resolution of claims related to the protection of information and innovation. What perceived benefit might cause the transactional lawyers to draft carve-outs, especially when the privacy of arbitration can help parties to protect the value of their private information or innovation?

We think that courts can provide several benefits to parties attempting to protect their information and innovation. First, parties evidently perceive courts as having a relative advantage in providing injunctive relief to the parties because in our studies of a variety of contract types, parties commonly expressly reserve a right to obtain such relief in courts.³³ Such property-type protections might well prove essential to the parties' efforts to protect the value of their information and innovation. In many cases, it may be functionally impossible to ascertain the money-damage equivalent of the loss of these items. For example, Gilson, Sabel, and Scott point to such difficulties in their explanation of the relatively unique form of contracts for innovation.³⁴ In particular, they emphasize the fact that in contracts for innovation, the parties cannot identify *ex ante* the innovative results of their collaboration, let alone value it; as a result, expropriation along the way toward development should pose daunting problems for ascertaining money damages.³⁵ In other contracts that do not themselves involve the creation of innovation, money damages for the loss of innovative rights can be very difficult, if not impossible, to prove. Indeed, scholars commonly lament the inadequacy of standard monetary damages in the context of information and innovation.³⁶

32. See, e.g., John M. Townsend, *Drafting Arbitration Clauses: Avoiding the 7 Deadly Sins*, DISP. RESOL. J., Feb.–Apr. 2003, at 28, 31 (“The drafter should be especially cautious about giving in to the temptation to advise the client to agree to arbitrate some types of disputes and go to court for others.”); see also Richard L. Lionberger, *Arbitration Clauses: Beware the Injunctive Relief Exception*, JD SUPRA L. NEWS (Aug. 21, 2013), http://www.jdsupra.com/post/file_server.aspx?fileName=6b7bd500-dc62-4c2d-b314-afb1d4c42ba0.pdf (“[I]f the parties desire that their disputes be arbitrated, including an exception for actions for specific performance would seem to make little sense.”).

33. As discussed in Part IV, in the aftermath of *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), several courts have imposed more onerous standards on the issuance of injunctions. See *infra* notes 143–44 and accompanying text. This practice could have the effect of dampening preferences for courts in some of our more recent contracts and in future contracts.

34. Gilson et al., *supra* note 20, at 194–95.

35. *Id.*

36. See, e.g., JANE C. GINSBURG ET AL., TRADEMARK AND UNFAIR COMPETITION LAW 917 (4th ed. 2007) (discussing the inadequacy of damages in trademark cases); Andrew S. Friedberg, *Possession as Threat: Temporary Injunctions to Protect Trade Secrets*, ADVOCATE, Winter 2008, at 77, 78 (rehashing the familiar notion that damages often do not fully compensate the trade



In addition, courts are better suited to providing the emergency relief that may be necessary to prevent serious harm to parties' intellectual property rights. Arbitrators typically have the authority to grant provisional relief.³⁷ But by the time an arbitrator is selected or an arbitral tribunal is constituted, which can easily take forty to ninety days,³⁸ substantial harm may already have occurred to a party's trademark or significant value from a patent or trade secret may already have been lost.³⁹ Although arbitration institutions sometimes provide standing panels for emergency relief,⁴⁰ parties seem to lack confidence in such arbitral procedures and only rarely use them.⁴¹ Because courts are continually in session and tend to apply predictable expedited hearing procedures,⁴² courts also have an advantage over arbitration for matters in which emergency relief may be important.

More generally, for contracts whose terms are largely unenforceable, as is the case for contracts for innovation, tools for ensuring cooperation are essential. Gilson, Sabel, and Scott explain that in these contracts the parties braid together a combination of enforceable and nonenforceable terms, with the enforceable terms protecting the end stage of the relationship.⁴³ This insight could be stated slightly differently: parties seek protection in the event that things go wrong, and one way for a party to protect itself is to specify a right to the information or innovation.⁴⁴ Moreover, a threat to be able to take the innovation can force the other party to cooperate and to renegotiate the terms of the relationship if needed. Many of the technology,

secret owner); Kollin L. Rice, *Ohio Law Governing Employee Covenants Not to Compete: A Practitioner's Guide to Current Trends and the Impact of Ohio's Adoption of the Uniform Trade Secrets Act*, 23 OHIO N.U. L. REV. 347, 362 & n.100 (1996) (highlighting the fact that damages in noncompetition-clause cases are "notoriously difficult to prove").

37. *E.g.*, UNIF. ARBITRATION ACT (2000) § 8(b), 7 U.L.A. 34 (2009); COMMERCIAL ARBITRATION RULES & MEDIATION PROCEDURES R-37 (AM. ARBITRATION ASS'N 2013); UNCITRAL MODEL LAW ON INT'L COMMERCIAL ARBITRATION art. 17 (2006).

38. *See, e.g.*, Stephen B. Goldberg, *The Mediation of Grievances Under a Collective Bargaining Contract: An Alternative to Arbitration*, 77 NW. U. L. REV. 270, 276 (1982) (citing an average of forty days for parties to select an arbitrator and up to ninety days for an experienced arbitrator). The time for arbitrator selection can be considerably longer if the parties fail to agree on an arbitrator or a party seeks to challenge a potential arbitrator's impartiality. *See id.*

39. *See* Drahozal & Ware, *supra* note 5, at 456–57 (noting that delays in arbitrator appointment can nullify the benefit of emergency relief).

40. For a discussion of the recent worldwide growth of such panels and procedures, see Jason Fry, *The Emergency Arbitrator—Flawed Fashion or Sensible Solution?*, 7 DISP. RESOL. INT'L 179 (2013).

41. Drahozal & Wittrock, *Flight from Arbitration*, *supra* note 27, at 78–79.

42. *E.g.*, FED. R. CIV. P. 64, 65.

43. *See* Gilson et al., *supra* note 20, at 196–98 (explaining that courts will enforce collaboration agreements by awarding reliance damages for failure to bargain in good faith rather than imposing a particular outcome, in order to encourage cooperation while recognizing that outcomes are unknowable and therefore uncommitted at the time of contracting).

44. Merges speaks of the matter as one where property rights enable the parties to cope effectively with contractual incompleteness. Robert P. Merges, *A Transactional View of Property Rights*, 20 BERKELEY TECH. L.J. 1477, 1486 (2005).

franchise, and joint-venture agreements that we studied contained provisions assigning rights to intellectual property used or developed during the course of the parties' relationship. Although retaining a right to intellectual property can be a form of self-help remedy, in fact a court might be needed to actually enforce the right.

Although these factors can help explain why parties seek injunctive relief in courts, we commonly observed broader carve-out provisions that enabled a party to proceed in court for the resolution of entire claims. In particular, parties expressed a preference for court resolution of claims involving noncompete and nonsolicitation clauses, confidentiality clauses, and intellectual property rights. What causes parties to seek to have these claims resolved in courts? Certainly the preferred remedy—typically injunctive relief—for claimed breaches of noncompete, nonsolicitation, and nondisclosure agreements remains an important part of the explanation.⁴⁵ In addition, courts are better able than arbitrators to provide judgments with in rem effect, good against the world rather than just the defendant.⁴⁶ The high stakes in at least some of the cases (such as trademark disputes for franchisors)⁴⁷ also are important. Parties often prefer to have courts resolve “bet-the-company” cases because the availability of appellate review reduces the risk of aberrational decisions.⁴⁸ Moreover, there likely are efficiencies to litigating claims in court once preliminary or permanent injunctions are sought there.⁴⁹ Other factors, including party demand for clear rules and legal expertise with relatively little demand for expertise regarding industry norms,⁵⁰ and the forecasted evidentiary needs of the parties,⁵¹ also could play a role.

45. If parties have not agreed to arbitrate, they are not bound by the arbitrator's decision. *E.g.*, *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 943 (1995).

46. For a discussion of the value of in rem protections embedded in property rights, see Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 780–89 (2001).

47. Drahozal & Wittrock, *Flight from Arbitration*, *supra* note 27, at 79–80.

48. Drahozal & Ware, *supra* note 5, at 455.

49. See Drahozal, “*Unfair*” *Arbitration Clauses*, *supra* note 27, at 763 (“[P]ermittting a party to go to court rather than arbitrate intellectual-property disputes may reduce dispute-resolution costs and increase the accuracy of the dispute-resolution process.”).

50. One commonly cited advantage of arbitration over litigation is the ability for the parties to choose arbitrators with industry and other professional expertise. See, e.g., DOUGLAS SHONTZ ET AL., RAND INSTITUTE FOR CIVIL JUSTICE, BUSINESS-TO-BUSINESS ARBITRATION IN THE UNITED STATES: PERCEPTIONS OF CORPORATE COUNSEL 16 (2011), available at http://www.rand.org/content/dam/rand/pubs/technical_reports/2011/RAND_TR781.pdf (reporting that almost 70% of corporate-counsel survey respondents listed the ability to control the arbitrator's qualifications as an attribute that encourages arbitration). In contrast, because U.S. courts operate according to the principles of stare decisis, litigation can provide more predictable, applicable legal precedents. Thomas et al., *CEO Employment Contracts*, *supra* note 27, at 973–74.

51. Parties typically are entitled to less discovery in arbitration than they would obtain in U.S. courts. 3 IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW § 34.1, at 34:2 (Supp. 1999).



Courts thus can provide an array of benefits to parties seeking to protect their innovations. Whether those benefits outweigh any associated costs is an empirical question, which the next Part addresses.

III. Party Demand for Courts: Empirical Evidence

We share with Ted Eisenberg and Geoff Miller the view that examining “the actual behavior of contracting parties” can provide important insights into the design of legal rules and dispute resolution systems.⁵² In this Part, we look at how parties contract to resolve disputes over the legal protections for their innovations. We examine a range of contract types and a variety of contract provisions, which consistently evidence the private value of courts in protecting innovation.

A. *Description of Contracts*

To illustrate the breadth of party preference for courts, we used samples of four types of contracts—technology contracts, CEO employment contracts, joint-venture contracts, and franchise contracts. The protection (and sometimes creation) of innovation plays a critical role in each type of contract. For example, one party to the technology contracts often licenses its innovation to the other; the licensor wants to protect its patent rights and trade secrets from misuse by the licensee. As head of the company, a CEO presumably has access to proprietary information and trade secrets of his or her employer. The CEO’s employment contract seeks to prevent improper disclosure of that information. In joint-venture agreements, the parties may be seeking to share or develop innovations. If the parties are sharing the innovation, the party with rights to the innovation wants to protect those rights in the contract. If the parties are engaged in innovation through the joint venture, the contract may specify the rights to any innovation that results. Central to the franchise relationship is the licensing of the franchisor’s trademark to the franchisee, often along with proprietary business methods. Again, the franchisor seeks to prevent misuse of its innovation in the event of a dispute or after the franchise relationship ends.

The technology contracts were gathered as follows: we collected a sample of 146 technology contracts filed with the Securities and Exchange Commission (SEC) between July 2007 and July 2011 and available on the

52. Theodore Eisenberg & Geoffrey P. Miller, *Damages Versus Specific Performance: Lessons from Commercial Contracts* 2 & n.8 (NYU Ctr. for Law, Econ. & Org., Working Paper No. 13-09, 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2241654; cf. William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 251–52 (1979) (examining “the use of arbitration as a benchmark for evaluation of the judicial system”).

Electronic Data Gathering, Analysis, and Retrieval System (EDGAR).⁵³ All of the filing companies were engaged in some sort of information-technology-related business, as identified by the four-digit Standard Industrial Classification code for the company. We gathered those contracts that seemed to represent everyday business contracts for the firm by eliminating contracts related to business formation and finance.⁵⁴ We also eliminated duplicate contracts. Most of the contracts (72%) were entered into between 2007 and 2010; the substantial majority (90%) were entered into between 2005 and 2011.⁵⁵

We also examined a sample of 915 CEO employment contracts from 1995 to 2005 collected from EDGAR by Randall Thomas, Ken Martin, and Erin O'Hara O'Connor,⁵⁶ and a small sample of joint-venture agreements collected from EDGAR in 2008.⁵⁷ The majority of the joint-venture agreements (59.6%—31 of 52) involved joint ventures with at least one non-U.S. party; the others were purely domestic U.S. joint ventures.⁵⁸

Finally, we used a sample of 67 franchise agreements from leading franchisors, obtained from the website of the Minnesota Department of Commerce.⁵⁹ The franchise agreements were included as exhibits to the franchisors' 2013 Franchise Disclosure Documents.⁶⁰ The sample itself traces from 1999, when available franchise contracts were obtained from franchisors then operating in Minnesota that were among the top 100 franchisors.⁶¹ Originally, 75 franchisors were in the sample; due to attrition (franchisors going out of business, ceasing to do business in Minnesota, and the like) the sample is now down to 67 franchisors.

53. For a more detailed description of the methodology for collecting the contracts, see Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 22).

54. The types of contracts were licensing agreements, service agreements, master service agreements, and the like, from the following industries: radiotelephone communications (such as wireless operators); telephone communications; data-processing services; computer-programming services; computer-integrated-systems design; computer-processing and data services; and other business services. *Id.*

55. *Id.* (manuscript at 22).

56. For more details on the methodology for collecting these contracts, see Thomas et al., *CEO Employment Contracts*, *supra* note 27, at 977–82.

57. Drahozal & Ware, *supra* note 5, at 465 & n.143.

58. *Id.* at 466 & tbl.4.

59. *Welcome to CARDS - Commerce Actions and Regulatory Documents Search*, MINN. DEPARTMENT COM., <https://www.cards.commerce.state.mn.us/CARDS/>.

60. Peter B. Rutledge & Christopher R. Drahozal, "Sticky" Arbitration Clauses?: *The Use of Arbitration Clauses After Concepcion and Amex*, 67 VAND. L. REV. (forthcoming 2014) (manuscript at 27), available at <http://ssrn.com/abstract=2306268>.

61. Drahozal, "Unfair" Arbitration Clauses, *supra* note 27, at 722–24 (describing the original sample); see also Drahozal & Wittrock, *Flight from Arbitration*, *supra* note 27, at 90–91 (using the same Minnesota franchise-agreement sample); Rutledge & Drahozal, *supra* note 60 (manuscript at 27) (same).



For each of the types of contracts, we coded for whether the contract included an arbitration clause. If the contract included an arbitration clause, we then coded for the presence of various types of carve-outs—claims for injunctive relief, claims for provisional relief, breach of a covenant not to compete, breach of a confidentiality agreement, and breach of a nonsolicitation agreement—and for trademark or other intellectual property disputes.

For technology and franchise contracts, we also coded for the presence of a specific performance clause—that is, a clause by which the parties consent that specific performance or injunctive relief is an appropriate remedy.⁶² Minnesota (the source of our franchise agreements) prohibits the use of specific performance clauses in franchise agreements.⁶³ However, most franchisors address such state-specific limitations through state-specific addenda to their franchise agreements, so we do not expect the Minnesota prohibition to affect our results significantly.⁶⁴ For the technology contracts, we identified whether the contracts discussed patent ownership so that we could isolate the effects of patent protection on party preference for courts and specific performance agreements. We also coded for the presence of a choice-of-court clause, either in the contract generally or in connection with a carve-out.

B. Party Demand for Courts in Contract Provisions

Empirically, we are interested in whether parties in their contracts prefer arbitration or courts when seeking to protect their innovations, through patent, trademark, or trade secret law;⁶⁵ and through various contractual provisions that enable the parties to better protect these rights.

62. We coded as specific performance clauses those contract provisions by which the parties agreed that injunctive relief was appropriate for particular claims or that specified that certain behavior “would” or “will” result in irreparable harm. We did not code as specific performance clauses those provisions stating that certain behavior “might” result in irreparable harm or provisions in which the parties agreed that no bond or only a limited bond would be required when a party seeks injunctive relief. Likewise, we did not treat as a specific performance clause a provision stating that nothing in the contract should be construed as eliminating the possibility of injunctive relief. Injunctive relief remains available under that type of provision, but under the usual standards for injunctive relief or specific performance in court. It does not exhibit a preference for specific performance over any other remedy.

63. *Registration Checklist*, MINN. DEPARTMENT COM., https://mn.gov/commerce/images/Franchise_Registration_Checklist.pdf (“The following Minnesota-specific language must be included in an exhibit attached to the Franchise Disclosure Document and also to the franchise agreements: . . . The franchisee cannot consent to the franchisor obtaining injunctive relief. The franchisor may seek injunctive relief. See Minn. Rules 2860.4400J.”) (emphasis omitted).

64. Almost all of the franchisors in our sample sell franchises nationally.

65. Copyright law apparently does not play an important role in protecting innovation in most of the types of contracts we studied. The technology contracts did address copyright issues at times, but only in a small sample of agreements, and often in conjunction with other intellectual property issues. And patent, trademark, and trade secret law may protect innovation to varying degrees, depending on the type of contract.

For each contract type, around half (or more) of the agreements studied included arbitration clauses—51.4% of technology contracts, 51.9% of CEO employment contracts, 42.9% of domestic joint-venture agreements, 71.0% of international joint-venture agreements, and 46.3% of franchise contracts.⁶⁶ The CEO employment contracts studied also showed a statistically significant time trend for arbitration: more parties are opting for arbitration over time.⁶⁷ One might infer from these figures that parties are divided almost evenly in their preferences between court and arbitration, or may even prefer arbitration in some types of contracts, and that arbitration's popularity is growing. A closer examination of the contracts, however, indicates otherwise, at least for some disputes: parties exhibit a strong preference for courts to protect their innovation in all contracts involving U.S. parties, as shown by their use of carve-outs from arbitration clauses, choice-of-court clauses, and specific performance clauses.⁶⁸ However, our contracts also indicate that the robustness of these results depends on party perceptions that the courts are equipped and willing to effectively enforce their rights. This subpart describes our results.

1. *Carve-outs from Arbitration Clauses.*—Carve-outs are provisions in arbitration clauses that exempt certain disputes, claims, or remedies from coverage under the arbitration clause.⁶⁹ They have the effect of enabling the parties to seek court assistance in resolving those matters.⁷⁰ Carve-outs permit parties to fine-tune their dispute resolution process by having different bundles of procedures (court or arbitral) apply to different types of disputes or remedies.⁷¹ By separating out the parties' potential disputes, the parties can quickly obtain more effective procedural customization than would be possible if the same dispute-resolution process applied to all potential disputes.⁷² When a contract contains a carve-out from an

66. Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 20, 22, 27, 29 & tbl.9). The technology contract numbers vary slightly here from those provided in Drahozal and O'Hara O'Connor because more technology contracts were included in the sample used for this Article.

67. Thomas et al., *CEO Employment Contracts*, *supra* note 27, at 981.

68. The empirical findings described below on the use of carve-outs and noncompete clauses are largely (although not exclusively) derived from our prior work. See *supra* note 27. The findings on choice-of-court clauses and specific performance clauses are original in this Article.

69. Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 3).

70. *Id.*

71. *Id.*

72. The available evidence suggests that contract provisions customizing the default procedures in court or arbitration are rare in contracts between sophisticated parties. See David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. 389, 394 (“[E]ven in circumstances where we would expect them to, parties almost never use contract terms to vary their post-dispute procedural contests.”); O'Hara O'Connor et al., *Customizing Employment Arbitration*, *supra* note 27, at 136–37 (finding that parties to CEO employment contracts rarely customized arbitration provisions).



arbitration clause, the parties are expressing an explicit preference for court resolution of the type of dispute being carved out from arbitration.⁷³

Carve-outs were common in all of the types of contracts we studied. Consider the technology contracts, which were all business-to-business contracts. Overall, 28.0% of the arbitration clauses studied contained carve-outs. Although this is a substantial number, isolating the contracts entered into by one or more U.S. companies produced more significant results. For contracts involving one or more U.S. companies, 59.4% of the arbitration clauses contained carve-outs. In contrast, contracts between two non-U.S. parties—which in our sample mostly included contracts between two Chinese firms—contained higher rates of arbitration clauses (65.1% of contracts) and almost no carve-outs from arbitration (3.6% of arbitration clauses). For contracts between two Chinese companies, more than 75% of the contracts contained arbitration clauses, and none of these contracts contained any carve-outs.

About half of the CEO employment contracts with arbitration clauses (48.2%) contained carve-outs. In addition, carve-outs have become increasingly common over time, with more recent contracts containing, on average, more carve-outs than the older contracts.⁷⁴ These figures are instructive because carve-outs were prevalent even for firms that were not primarily engaged in innovation. Whatever the proportion of firm business dedicated to innovation, the firm commonly sought to protect its value by preserving a right to proceed in court. CEO employment contracts tend to be heavily negotiated agreements with lawyers representing the parties on both sides.⁷⁵ This fact suggests that the protections are valuable enough to the firm that it is willing to actively negotiate to keep them.

The joint-venture agreements exhibited a similar contrast. Just over a quarter of the joint-venture agreements (27.6%—8 of 29) contained carve-outs. Within the sample, however, 20.0% of international joint ventures and 44.4% of U.S. joint ventures with arbitration clauses contained carve-outs. Finally, all of the franchise agreements we studied used some form of carve-out when the contract contained an arbitration clause.⁷⁶ The franchise agreements are all domestic (involving only U.S. parties) and are form contracts drafted by the franchisor. In virtually all cases, the carve-outs operate in favor of the franchisor.

The most common carve-outs varied depending on the type of contract, but in every case were closely linked to the need to protect innovation. In technology contracts, the most common carve-out was for injunctive relief claims, which appeared in 25.3% of the contracts with

73. Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 16).

74. O'Hara O'Connor et al., *Customizing Employment Arbitration*, *supra* note 27, at 175.

75. Thomas et al., *CEO Employment Contracts*, *supra* note 27, at 964.

76. *See infra* Tables 1, 2, 3 & 4.

arbitration clauses, as shown in Table 1. The second most common was for claims based on a confidentiality clause in the contract, used in 13.3% of the contracts with arbitration clauses. In CEO employment contracts, as shown in Table 2, 35.7% of the contracts with arbitration clauses carved out claims based on a contractual confidentiality obligation, 31.0% carved out noncompete claims, and 29.5% carved out nonsolicitation claims. As shown in Table 3, in the domestic joint-venture agreements, a third of arbitration clauses (33.3%) carved out claims for provisional relief, and one clause carved out injunctive relief claims; 10.0% of arbitration clauses in international joint-venture contracts carved out injunctive relief claims. The use of carve-outs was highest in franchise contracts, as shown in Table 4, presumably at least in part because franchise contracts are not individually negotiated.⁷⁷ Over 87% of the franchise agreements with arbitration clauses carved out injunctive relief claims, 71.0% carved out trademark claims, 35.5% carved out nonsolicitation claims, and 41.9% carved out noncompete claims.

Table 1: Carve-Outs in Technology Contracts⁷⁸

Type of Carve-Out	Number of Contracts with Carve-Outs	Percentage of Arbitration Clauses with Carve-Outs
Any carve-out	21	28.0%
Injunctive relief claims	19	25.3%
Confidentiality-clause claims	10	13.3%
Noncompete-clause claims	1	1.3%
Nonsolicitation-clause claims	1	1.3%

77. See Drahozal, *"Unfair" Arbitration Clauses*, *supra* note 27, at 723 (explaining that individually negotiated changes to franchise agreements would need to be filed with the Minnesota Department of Commerce).

78. Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 23 & tbl.2).



Table 2: Carve-Outs in CEO Employment Contracts⁷⁹

Type of Carve-Out	Number of Contracts with Carve-Outs	Percentage of Arbitration Clauses with Carve-Outs
Any carve-out	224	48.2%
Noncompete-clause claims	144	31.0%
Confidentiality-clause claims	166	35.7%
Client-nonsolicitation-clause claims	99	21.3%
Employee-nonsolicitation-clause claims	137	29.5%
Nondisparagement-clause claims	30	6.5%
Preliminary relief carve-out	56	12.0%

Table 3: Carve-Outs in Domestic and International Joint-Venture Agreements⁸⁰

Type of Carve-Out	Number of Contracts with Carve-Outs	Percentage of Arbitration Clauses with Carve-Outs
Domestic Agreements:		
Any carve-out	4	44.4%
Provisional relief claims	3	33.3%
Injunctive relief claims	1	11.1%
International Agreements:		
Any carve-out	4	20.0%
Provisional relief claims	1	5.0%
Injunctive relief claims	2	10.0%
IP, trade secrets, and corporate opportunities	1	5.0%

79. *Id.* (manuscript at 20 & tbl.1). To be clear, the study of 915 contracts yielded 475 contracts indicating that the parties would resolve at least some of their disputes with arbitration. Only 465 of these contracts actually contained the arbitration clause, however. The percentages in Table 2 above all use the 465 contracts studied as the relevant denominator.

80. *Id.* (manuscript at 27–28 & tbl.7).

Table 4: Carve-Outs in Franchise Agreements

Type of Carve-Out	Number of Contracts with Carve-Outs	Percentage of Arbitration Clauses with Carve-Outs
Any carve-out	31	100.0%
Injunctive relief claims	27	87.1%
Claims to protect trademark	22	71.0%
Noncompete clause claim	11	35.5%
Confidentiality clause claims	13	41.9%

Full appreciation of party preferences for courts over arbitration requires combining the data on carve-outs with the data on the overall use of arbitration clauses.⁸¹ For example, 51.4% of technology contracts used arbitration clauses; 48.6% did not. Of the 51.4% with arbitration clauses, 25.3% carved out injunctive relief claims from arbitration. Combining those data, 61.6% of technology contracts provided for injunctive relief claims to be resolved in court.⁸² If we consider just cross-border contracts, a similar calculation shows that 85.7% of the agreements call for court resolution of the claims.⁸³ For CEO employment contracts, 66.6% provided for confidentiality-clause claims to be resolved in court,⁸⁴ and 64.2% provided for noncompete-clause claims to be decided in court.⁸⁵ For domestic joint ventures, 71.4% provided for claims for provisional relief to be resolved in court,⁸⁶ but only 36.1% of international joint ventures provided for injunctive relief claims to be resolved in court.⁸⁷ For franchise agreements, the numbers were more dramatic: when the data on arbitration-clause use and carve-outs are combined, 94.0% of franchise agreements provided for injunctive relief claims to be resolved in court,⁸⁸ and 86.6% of franchise agreements provided for trademark claims to be resolved in court.⁸⁹

81. See *supra* note 66 and accompanying text.

82. $48.6\% + (51.4\% * 25.3\%) = 61.6\%$.

83. $57.1\% + (42.9\% * 66.7\%) = 85.7\%$. For additional data on cross-border contracts, see Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27, at 24 tbl.5.

84. $48.1\% + (51.9\% * 35.7\%) = 66.6\%$.

85. $48.1\% + (51.9\% * 31.0\%) = 64.2\%$.

86. $57.1\% + (42.9\% * 33.3\%) = 71.4\%$.

87. $29.0\% + (71.0\% * 10.0\%) = 36.1\%$.

88. $53.7\% + (46.3\% * 87.1\%) = 94.0\%$.

89. $53.7\% + (46.3\% * 71.0\%) = 86.6\%$.



Not considering carve-outs can substantially understate the extent of party preferences for courts.⁹⁰ For example, Matthew Jennejohn reports that 49.7% of collaboration agreements he collected from EDGAR and 67.6% of collaboration agreements available on www.onecle.com included arbitration clauses.⁹¹ Based on this (relatively) high frequency of arbitration clauses, he concludes that “collaborators shun litigation,” arguing that “contemporary contract adjudication is fundamentally inappropriate for fixing dysfunctional learning systems.”⁹² We have no ability to replicate the sample Jennejohn collected from EDGAR, but have examined the sample of collaboration agreements currently available on www.onecle.com. Of the available agreements dated 2004–2008 (the most recent agreements available), just under half (48.0%—12 of 25) included arbitration clauses. But half of the collaboration agreements with arbitration clauses (including three-quarters of domestic agreements) used some sort of carve-out, most commonly for provisional relief.⁹³ So focusing solely on arbitration clauses to the exclusion of carve-outs can substantially understate the extent to which parties contract for courts to assist them in resolving their disputes.

2. *Choice-of-Court Clauses.*—Why do parties so often prefer courts to arbitration for the protection of their innovation? Recall that our instinct was that property-type protections are essential for the effective protection of information and innovation, and that courts can more effectively provide these remedies than can arbitrators.⁹⁴ Can the contracts provide us with any evidence of this motivation? In an effort to seek out this evidence, we studied some of the contracts for the presence of choice-of-court and specific performance clauses. We treat the choice-of-court clauses in this subpart and the specific performance clauses in the next subpart.

If the parties seek courts in order to provide property-type protections, then they should be less inclined to specify an exclusive venue for the resolution of their disputes. This reasoning requires some defense because, at first glance, specifying a particular court should serve the benefit of enabling the parties to steer away from unreliable courts (i.e., Chinese and California courts as described in the last subpart)⁹⁵ and toward more reliable

90. In addition to the example that follows, see also *infra* text accompanying notes 100–04 (discussing Eisenberg & Miller’s study of specific performance clauses).

91. Jennejohn, *supra* note 23, at 198, 200.

92. *Id.* at 201.

93. We are dealing with a different issue in this Article than the one discussed by Jennejohn, and we certainly recognize that arbitration can play an important role in resolving some sorts of disputes among collaborators. But like the other types of contracts we studied, collaboration agreements also appear to provide for an important role for courts in protecting innovation.

94. See *supra* text accompanying notes 34–51.

95. See *infra* text accompanying notes 109–18.

ones. Although this is true, a party seeking to prevent another party from expropriating information or innovation likely would not wish to confine itself to a single jurisdiction. Rather, that party presumably would want the freedom to seek injunctive relief in any jurisdiction where the other party is attempting to benefit from use of the information or innovation, at least where the location of such expropriations cannot be reliably predicted. Stronger courts are better than unreliable courts, to be sure, but a party seeking injunctive relief nevertheless could prefer to choose its jurisdiction after the facts of expropriation have been revealed.

If this reasoning is correct, it has implications for the choice-of-court clauses one might see in our contracts. Specifically, we compared the use of the clauses in the two settings where the parties contemplate using courts for the resolution of at least some of their disputes: (1) contracts without arbitration clauses and (2) contracts containing arbitration clauses with carve-outs. For the latter contracts, the parties have explicitly contemplated a need for courts to protect their information and innovation. For the former contracts, the parties' motivation presumably is much less clear. Parties could choose not to incorporate an arbitration clause for many reasons, including a failure or reluctance to bargain for dispute resolution, or a distrust of arbitration for any number of reasons. If parties seek courts in order to obtain property-type protections for their innovation, then choice-of-court clauses should appear less often in contracts that explicitly carve out rights to go to court for such claims. Conversely, they should appear relatively more often in contracts with no arbitration clause because those contracting parties might or might not be motivated by concerns for protection of innovation.

Using this reasoning, we returned to the technology contracts to study choice-of-court clauses, and we found a dramatic difference in the rates with which contracts incorporated choice-of-court clauses. For the 21 contracts with arbitration clauses and carve-outs, only 2 (9.5%) included a choice-of-court clause limiting a party's right to obtain relief in a particular court or courts.⁹⁶ In contrast, 39 of the 71 (54.9%) contracts without an arbitration clause contained a choice-of-court provision. These differential numbers cannot prove our hypothesis, but they certainly support it. Moreover, several of the 37 choice-of-court clauses found in the contracts without arbitration clauses gave the parties a clear or possible right to proceed to any court to obtain injunctive relief. These provisions serve as carve-outs of the choice-of-court clauses, presumably to ensure that the

96. Actually, a third contract contained a type of choice-of-court clause, but we chose not to count this contract. The contracting parties were both U.S. companies, and the contract gave the parties the right to proceed in any U.S. court. We viewed this clause as permissive rather than restrictive, given the circumstances.

parties can more effectively obtain property-type relief for the protection of their innovation.

Moreover, virtually all of the contracts designating a U.S. forum specify that the parties can proceed in state or federal court in a particular state or district. Presumably, the choice enables the parties to obtain more effective IP protections in federal courts (i.e., for patent, trademark, and copyright claims) while preserving a right to proceed in state court for the resolution of other types of claims.

3. Specific Performance Clauses.—Another indicator of the importance to parties of property-type protections is the presence of contract clauses modifying the usual rules for awarding injunctive relief or specific performance. In particular, contract clauses will sometimes state that the parties acknowledge or agree that in the event of a breach of the contract provision, the nonbreaching party is likely to suffer irreparable injury and that injunctive relief is therefore appropriate.⁹⁷ The clauses are an effort to ensure that courts will be willing to award injunctive relief without the usual extensive inquiry into whether the legal standard is satisfied.⁹⁸ A recent paper by Ted Eisenberg and Geoff Miller examines the use of “specific performance clauses” to evaluate party preferences for a specific performance remedy over damages.⁹⁹ Our focus here is narrower: we are interested in contract provisions that help explain why parties prefer courts to arbitration for injunctive relief remedies. Nevertheless, our findings do have possible implications for some of Eisenberg and Miller’s findings.

We looked for the presence of specific performance clauses in the technology contracts. Although we found several such provisions, their presence was almost exclusively a U.S. phenomenon. When at least one of the parties to the contract was located in the United States, 53.6% (45 of 84) of the contracts included a specific performance clause. When neither party was located in the United States, only 1.6% (1 of 62) of the contracts included a specific performance clause. Of the 46 contracts with specific performance clauses, 27 (58.7%) provided that all disputes will be resolved in court (no arbitration clause), 14 (30.4%) included an arbitration clause with a carve-out, and only 5 (10.9%) provided for arbitration with no carve-out. By comparison, 49 of the 100 (49.0%) contracts without a specific performance clause included an arbitration clause with no carve-out. Moreover, specific performance clauses were more common in contracts that contained arbitration clauses with carve-outs than in contracts with no arbitration clause. Twenty-seven of the 71 contracts with no arbitration clause (38.0%) contained specific performance clauses, whereas 14 of the

97. Eisenberg & Miller, *supra* note 52, at 3–5.

98. *Id.* at 3–4.

99. *Id.* at 2–6.

21 contracts with carve-outs (66.7%) contained specific performance clauses. Given that the contracts contemplating dispute resolution in court are significantly more likely to contain specific performance clauses, the technology contracts lend further support to the hypothesis that U.S. parties desire courts in order to seek property-type protections.

Of the franchise agreements we studied, 59.7% (40 of 67) included a specific performance clause. Specific performance clauses were more common in franchise agreements without arbitration clauses (66.7%—24 of 36) than franchise agreements with arbitration clauses (51.6%—16 of 31). However, all but two of the franchise agreements with arbitration clauses and specific performance clauses (87.5%—14 of 16) also used injunctive relief carve-outs. And the two remaining franchise agreements had carve-outs for disputes over trademarks (in one case) and disputes over trademarks and confidential information (in the other), which were the very types of disputes addressed by the specific performance clause. All told, all of the forty franchise agreements with specific performance clauses either had no arbitration clause or an arbitration clause with a carve-out. In all of the agreements, it would be courts rather than arbitrators that would rule on the request for injunctive relief.

Moreover, the specific performance clauses in the franchise agreements studied consistently linked the need for injunctive relief to protections for trademarks, trade secrets, and confidential information. Here are a few examples:

- AAMCO: “in view of the nature of the System, the business of AAMCO, and the strength of the AAMCO names and marks.”
- Cost Cutters: “The FRANCHISEE, the FRANCHISEE’S shareholders, partners or members and the Personal Guarantors agree that the provisions of this Article are necessary to protect the legitimate business interests of COST CUTTERS and COST CUTTERS’ franchisees, including, without limitation, preventing damage to and/or loss of goodwill associated with the Marks, preventing the unauthorized dissemination of marketing, promotional and other confidential information to competitors of COST CUTTERS and COST CUTTERS’ franchisees, protection of COST CUTTERS’ trade secrets and the integrity of COST CUTTERS’ Business System and preventing duplication of the Business System.”
- Denny’s: “the unique value and secondary meaning attached to the Denny’s System, the Denny’s Marks, the Confidential Information and the associated standards of operation and trade practices.”



- Dunkin' Donuts: "the importance of your compliance with Standards to protect our System, other franchisees, and the goodwill enjoyed by our Proprietary Marks."
- KFC: "as a KFC franchisee, he will have access to KFC's trade secrets and confidential practices and therefore, is in a unique position to use the special knowledge he will have gained while a franchisee."
- Quizno's: "the Marks and the Licensed Methods have valuable goodwill attached to them, that their protection and maintenance are essential to Franchisor and its affiliates."

The specific performance clauses themselves thus provide some indication that injunctive relief is important for protecting innovation.

Our empirical results stand in sharp contrast to those of Eisenberg and Miller, who found that specific performance clauses were more common in contracts with arbitration clauses than ones without.¹⁰⁰ There are several possible explanations for our differing findings. First, our studies use different contracts. The technology contracts would be included in the Eisenberg and Miller sample, but the franchise agreements would not. And the Eisenberg and Miller sample included a number of other types of contracts we do not study here.¹⁰¹ Second, and importantly, Eisenberg and Miller do not distinguish between arbitration clauses with injunctive relief carve-outs and arbitration clauses without such carve-outs.¹⁰² Such carve-outs indicate that the specific performance clauses are directed to courts rather than arbitrators, as Eisenberg and Miller presume.¹⁰³ Third, Eisenberg and Miller appear to employ a significantly broader definition of specific performance clause than we use here. They employ a relatively simple word search that will capture more than just specific performance clauses, whereas we had few enough contracts that we could read each one to be certain that it contained such a clause.¹⁰⁴ Overall, our findings here do

100. *Id.* at 38 tbl.7.

101. *Compare id.* at 22 tbl.1 (sampling twelve types of contracts, including employment, merger, and underwriting contracts), with discussion *supra* subpart III(A) (sampling technology contracts, CEO employment contracts, joint-venture contracts, and franchise contracts).

102. *See id.* at 29–30.

103. Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 40).

104. As explained above, we do not include injunctive relief carve-outs, no-bond requirements, or no-waiver-of-injunctive-relief provisions as specific performance clauses. *See supra* note 62. By comparison, it appears that Eisenberg and Miller may include some of those provisions. They describe their coding of specific performance clauses as follows:

The key outcome variable in this study is the contracts' treatment of remedies, with particular focus on the remedy commonly referred to as specific performance. To determine whether a contract included specific performance as a remedy, we used terms associated with departures from the default damages rule. We searched the retrieved SEC documents for the following terms: "specific!, injunc!, irre! (to capture Irreparable and Irrevocable), adequate, equit!, remedies, relief." The "!" symbol in

not fundamentally challenge the central finding of Eisenberg and Miller (that parties often contract for specific performance), but they do raise questions about Eisenberg and Miller's subsidiary finding that such provisions are more common in contracts with arbitration clauses.

4. *Patent Protection Versus Other Protection of Innovation.*—The different contracts that we studied protect innovation through different bodies of intellectual property. The franchise agreements seem primarily focused on trademark protection, while the CEO employment contracts focus more on trade secret protection. We wanted to get a sense of how contract provisions might differ if the parties were focused on patent protection rather than other types of protection. Patent disputes are not arbitrable in all countries,¹⁰⁵ and scholars debate whether it makes sense for such cases to be handled in arbitration.¹⁰⁶ Moreover, one might think that patent cases are more likely to end up in public court than trademark and trade secret cases for several reasons, including that parties to patent disputes can file suit in specialized courts with expert judges,¹⁰⁷ and that the intellectual property at issue is already in the public domain, so the confidentiality of arbitration is less necessary.¹⁰⁸

To get a sense of how parties treat patent issues, we returned to the technology contracts. Not all of these contracts contemplate the protection of innovation, let alone patent issues, however. We isolated those contracts that discussed patent-ownership issues as a measure of those parties who were particularly focused on patent issues when negotiating the contract. In the seventy-seven contracts discussing patent ownership between the parties, twenty-four (31.2%) specified that all disputes were to be resolved in arbitration, thirty-four (44.2%) that all disputes were to be resolved in court, and nineteen (24.7%) included an arbitration clause with a carve-out

some of the search terms is the commonly used symbol to include any combination of characters that follow the root term. For example, “injunc!” would include documents that contain the words “injunction” or “injunctive”. Documents that satisfied the search term were then read to ascertain whether they in fact addressed specific performance.

Eisenberg & Miller, *supra* note 52, at 23. They recognize the possibility that their search terms are underinclusive and add some contract provisions that have a similar effect as a specific performance clause. *Id.* at 23–24. But they do not discuss the possibility that their search terms are overinclusive.

105. M.A. Smith et al., *Arbitration of Patent Infringement and Validity Issues Worldwide*, 19 HARV. J.L. & TECH. 299, 333, 345 (2006) (listing France and China as examples of countries where patent disputes are non-arbitrable).

106. *See id.* at 306–13 (addressing legal and policy arguments against arbitration proceedings for patent disputes).

107. *See infra* text accompanying notes 132–37.

108. *See* WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 294–95 (2003) (explaining that patent law requires public disclosure of the relevant invention).



for some disputes. By comparison, in the sixty-nine technology contracts that did not discuss patent ownership issues, thirty (43.5%) specified that all disputes were to be resolved in arbitration, thirty-seven (53.6%) that all disputes were to be resolved in court, and two (2.9%) included an arbitration clause with a carve-out for some disputes. As these figures indicate, contracts that expressly contemplate patent matters tend to steer parties away from arbitration and toward courts, at least to some extent. The differences are not dramatic, however, which further reinforces our observations from other contracts that parties seek courts for innovation protections more generally. Interestingly, however, the parties were much more likely to incorporate carve-outs from arbitration in contracts discussing patent rights. Perhaps the parties see patent matters as significantly more unique and separable than matters that involve other forms of intellectual property. This makes intuitive sense, given that trade secrets are protected through a variety of common contract terms, including noncompete, confidentiality, nonsolicitation, and benefits/severance clauses.

Parties contemplating the need for patent protections might also seek courts due to the special value of injunctive relief for patent owners. In support of this hypothesis, technology contracts that discuss patent ownership issues are much more likely to include specific performance clauses than are the contracts that do not discuss patent-ownership rights. Just over half (51.9%—40 of 77) of contracts discussing patent rights include specific performance clauses, while less than ten percent (8.7%—6 of 69) of contracts that do not discuss patent ownership include such clauses.

5. *Desirability of Courts.*—Our contracts provide evidence that party preference for courts is critically dependent on the parties believing that courts can, and will, provide them with the protections they seek. If parties do not trust the courts to provide them with effective protections, then they will be more inclined to opt for arbitration and less inclined to carve out claims for court resolution. This pattern is present in the technology agreements entered into between two companies located in China. Of the forty-nine contracts involving two companies formed in China, thirty-eight (77.6%), of them contain an arbitration clause, and none of the arbitration clauses contain carve-outs of any kind. Thus, at most, 22.4% of contracting parties are comfortable proceeding to court for the resolution of their disputes, a much lower number than we saw for other contracts. Although China recently has invested significant resources in IP courts, they are not

yet thought to be effective for protecting IP rights.¹⁰⁹ This relative distrust of the local courts shows up in the parties' contracts.

The CEO employment contracts also are illustrative. Firms in our sample were located across the United States, with 112 of the contracts in our sample primarily located in California, according to the Compustat database.¹¹⁰ California courts will not enforce noncompete provisions in employment contracts.¹¹¹ Given that noncompetition clauses were commonly found in the CEO employment contracts, one might expect to see a difference in California firm preferences for arbitration relative to firms located in other states. In fact, 67% of the CEO employment contracts with firms primarily located in California contained arbitration clauses, a much higher rate than that found for the other firms (49%), with the differences being statistically significant.¹¹² Statistically significant differences showed up in the carve-out rates too. Very few firms primarily located in California signed contracts carving out noncompete-clause claims for court resolution.¹¹³ That result seems to follow straightforwardly from the fact that California firms' noncompete-clause claims can only be enforced in arbitration.¹¹⁴ Interestingly, however, firms primarily located in California were also statistically less likely to carve out other types of claims for court resolution.¹¹⁵ This difference might well be due to the fact that the California courts will strike down arbitration clauses in their entirety in employment contracts if it appears that the employer is carving out rights to proceed in court while forcing the employee to bring claims in arbitration.¹¹⁶ This precedent has even been applied both to cases where

109. See Drahozal & O'Hara O'Connor, *Unbundling Procedure*, *supra* note 27 (manuscript at 42) (discussing the difficulties faced by specialized intellectual property courts in China).

110. O'Hara O'Connor et al., *Customizing Employment Arbitration*, *supra* note 27, at 161.

111. Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 607-08 (1999).

112. O'Hara O'Connor et al., *Customizing Employment Arbitration*, *supra* note 27, at 161-62.

113. *Id.* at 170 (non-California firms carved the noncompete-clause claims out in 38% of the arbitration clauses; California firms carved them out in only 5% of the clauses).

114. See *supra* text accompanying note 111.

115. O'Hara O'Connor et al., *Customizing Employment Arbitration*, *supra* note 27, at 168 tbl.6.

116. For examples of cases in which the entirety of an arbitration clause was struck down by a California court, see *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 674 (Cal. 2000); *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88, 107 (Cal. Ct. App. 2004); *Martinez v. Master Prot. Corp.*, 12 Cal. Rptr. 3d 663, 673 (Cal. Ct. App. 2004); *Abramson v. Juniper Networks, Inc.*, 9 Cal. Rptr. 3d 422, 444 (Cal. Ct. App. 2004); *O'Hare v. Mun. Res. Consultants*, 132 Cal. Rptr. 2d 116, 125 (Cal. Ct. App. 2003); *Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671, 684 (Cal. Ct. App. 2002).

employers carve out rights to innovation¹¹⁷ and to cases involving corporate officers and executives.¹¹⁸

The California firm CEO employment agreements and the Chinese firm technology agreements both provide evidence that party preference for courts is contingent on their subjective belief that the courts can, and will, provide them with the protections they seek. If firms opt for courts in general but turn to arbitration when court enforcement is unreliable, it is possible that the court precedent is having the effect of destroying value for the contracting parties. Such value destruction is only justified if the state can identify a greater social benefit to its obstructive stance. Overall, it suggests that states should very carefully consider how local laws influence party efforts to protect their information and innovation.

C. Summary

To summarize, empirical studies of contracting for dispute resolution have overlooked the fact that parties seeking to protect their rights to innovation appear to have a strong preference for courts rather than arbitration. In a wide variety of commercial environments where parties seek to use a number of different tools for protecting innovation (such as patents, trademarks, and trade secrets), a preference for courts appears in the contracts. One must be careful not to generalize from our contract studies too far. After all, we study high-value contracts entered into by mostly publicly traded firms, which may give some bias to our results.¹¹⁹ Nevertheless, across these several environments studied, the preference for courts is clear. Often this preference takes the form of carve-outs from arbitration clauses, a phenomenon receiving scant attention so far in the literature. When the parties focus on carve-outs, they are reluctant to specify the courts where such relief can be obtained, presumably so that the protections can be obtained anywhere. In contrast to prior study,¹²⁰ we find that specific performance clauses are more prevalent when parties contemplate court protection of innovation, providing further evidence that a primary benefit of courts is more effective injunctive relief. Finally, in the technology agreements, parties contemplating a need for patent

117. For examples of cases in which the entirety of an arbitration clause was struck down by a California court despite the employer carving out rights to innovation, see *supra* note 116.

118. See, e.g., *Trivedi v. Curexo Tech. Corp.*, 116 Cal. Rptr. 3d 804, 808 (Cal. Ct. App. 2010) (relating to an arbitration provision in an employment contract between a corporation and its president and chief executive officer); *Kalmbach v. Sportsmobile W., Inc.*, No. F054648, 2008 WL 4988663, at *1, *9 (Cal. Ct. App. Nov. 25, 2008) (relating to an arbitration agreement in the contract of a vice president of operations); *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138, 148 (Cal. Ct. App. 1997) (relating to an arbitration provision in an employment contract between a corporation and chief financial officer).

119. Cf. *Drahozal & Ware*, *supra* note 5, at 457–67 (detailing how Eisenberg and Miller's sample is biased “in favor of contracts unlikely to include arbitration clauses”).

120. See *supra* notes 100–04 and accompanying text.

protections were even more likely to express a preference for courts over arbitration, were more likely to use carve-outs to preserve such rights, and were significantly more likely to incorporate specific performance clauses than were other parties. Our contracts indicate that party preference for courts is highly contingent, however, turning on party perceptions of the ability and willingness of the courts to provide effective protection of their innovations.

IV. Implications for Court Rules

Whatever might be true regarding the relevance of courts in other commercial contexts, they appear to be important to many parties attempting to protect their information and innovation. In a world where these attributes represent an increasing fraction of the value of transactions,¹²¹ the role of courts in commercial exchange should grow rather than shrink over time. Importantly, however, party demand for courts is not wholly inelastic; our empirical studies demonstrate that parties located in jurisdictions with courts that provide weak protections for innovation are more likely than other parties to opt for arbitration.¹²² Put differently, where court rules or procedures interfere with parties' ability to protect their innovation, parties will do what they can to avoid them.

If courts desire to provide value to contracting parties, thereby facilitating transactions involving innovation, then particular attention should be paid to the procedural and substantive rules that are applied to claims involving the protection of innovation. In particular, the data suggests that nations wishing to compete effectively for technologically sophisticated investments must do more than credibly commit to enforcing arbitration clauses and awards. Court reforms are likely essential.

What will matter to contracting parties are the rules and standards applied to the granting of injunctive relief, as well as the substantive doctrines most likely to affect contracting parties, particularly the ability of parties to contract for innovation protections. This point requires a bit of elaboration here. Outside the context of enforcing contract terms, arbitrators very typically apply the same governing rules that are used by courts,¹²³ so at first glance it is not clear that the substantive legal principles applied in courts would drive parties to arbitration. Where the substantive rules are influenced by contract law principles, however, the results in the

121. See, e.g., Jean Raymond Homere, *Intellectual Property Rights Can Help Stimulate the Economic Development of Least Developed Countries*, 27 COLUM. J.L. & ARTS 277, 280 (2004) ("Intellectual property has been recognized as the most valuable asset in many commercial transactions . . .").

122. See *supra* section III(B)(5).

123. See Christopher R. Drahozal, *Is Arbitration Lawless?*, 40 LOY. L.A. L. REV. 187, 214 (2006) ("The attitudes of arbitrators toward following the law do not appear all that different from the attitudes of judges . . .").



two forums can differ. The issue is essentially a matter of contract enforceability. In arbitration, the parties' contract is paramount,¹²⁴ but for courts, governing legal principles are more likely to trump the contract.¹²⁵

For example, a court in jurisdiction X might insist on the application of X law to the parties' claim, whereas an arbitrator is more likely to apply the law of jurisdiction Y if the parties state in their contract that Y law is to apply. Even when it is clear that X law will generally apply, parties sometimes attempt to contract for an effective alteration of the legal standard. Consider, for example, noncompete clauses. The general rule is that an employee is free to take up any alternative work once she leaves a firm, but a noncompete clause is an attempt to contract around the employee's freedom to prevent the loss of trade secrets or other proprietary information.¹²⁶ Some, but not all, courts will enable parties to contract for this protection.¹²⁷ Consider also the standard for obtaining an injunction. Parties might attempt to incorporate a different standard into their contract, or, as we observed in our contracts, they might contract for terms that suggest one party automatically concedes that the standard, or at least part of its factors, is satisfied.¹²⁸ If courts are more reluctant to enforce these provisions, parties may be driven to arbitration, which deprives them of the benefits to court resolution of their disputes.

We do not mean to suggest that courts should enforce party contracts related to innovation regardless of what the contracts say and of the policy goals embedded in the generally applicable rules. Instead, our assertion is more modest: courts should pay careful attention to the rules that they craft in the context of innovation because they can entail underappreciated economic costs. By driving parties to arbitration or otherwise making it more difficult for them to protect their innovation, less innovation, less value-enhancing trade, or both, might result. These costs are less significant in other commercial contexts—i.e., contexts not involving innovation—where arbitration serves as an effective substitute to court resolution of disputes.

Given that we are not ourselves experts in intellectual property, we must leave to others a full debate over the policy implications of our empirical findings. We mention here just a few matters that seem to be worthy of further consideration. First, courts and legislators should

124. Cf. Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 569 (2003) (highlighting that arbitrators may be more likely to enforce contractual punitive damages restrictions than courts).

125. *See id.*

126. Bruce Kobayashi & Larry Ribstein, *Privacy and Firms*, 79 DENV. U. L. REV. 526, 530 (2002).

127. *Id.*

128. *See supra* section III(B)(3).

consider whether it makes sense to set up courts with special expertise in IP matters. Within the United States, the Maryland Business and Technology Court is an example.¹²⁹ In addition, some have proposed specialized patent trial courts within the United States whose conclusions would be entitled to deference in the U.S. Court of Appeals for the Federal Circuit.¹³⁰ In the United Kingdom, the Intellectual Property Enterprise Court (located in London) hears patent, copyright, and trademark claims.¹³¹ In addition to providing specialized judges, the court applies special rules designed to enable more effective case management and lower cost assessments.¹³²

One of the advantages of arbitration is that parties can pick arbitrators with expertise in the subject matter of their dispute,¹³³ and specialized courts can replicate (to some extent at least) that capability for courts. It certainly is the case that states and judges are setting up business courts, in part, in response to perceived competition from arbitration.¹³⁴ That said, none of the contracts we studied specifically contracted for disputes to be resolved in a specialized business or technology court, which at least raises questions about their perceived value to parties. However, one explanation for a failure to designate specific courts is a desire to obtain injunctive relief wherever necessary to protect the innovation.¹³⁵ Regarding expert judges, parties to contracts that contemplate patent actions—which are more commonly resolved by expert judges¹³⁶—seem more likely to choose courts rather than arbitration to resolve those claims. At the very least, more careful study of party preferences seems warranted.¹³⁷

129. See John F. Coyle, *Business Courts and Interstate Competition*, 53 WM. & MARY L. REV. 1915, 1969 (2012) (describing specialized courts created under the Maryland Business and Technology Case Management Program).

130. Arti K. Rai, *Specialized Trial Courts: Concentrating Expertise on Fact*, 17 BERKELEY TECH. L.J. 877, 877–79 (2002).

131. *Intellectual Property Enterprise Court (Formerly Patents County Court)*, HM COURTS & TRIBUNALS SERV., JUSTICE, <http://www.justice.gov.uk/courts/rcj-rolls-building/intellectual-property-enterprise-court> (last updated Jan. 9, 2014). This court was formerly called the Patents County Court, which was established in 1990. HM COURTS & TRIBUNALS SERV., THE PATENTS COUNTY COURT GUIDE 3 (2012), available at <http://www.justice.gov.uk/downloads/courts/patents-court/patents-court-guide.pdf>.

132. Sarah Cook, *Patents County Court Restructures to Become the Intellectual Property Enterprise Court*, MONDAQ, <http://www.mondaq.com/x/267172/Trademark/Patents+County+Court+Restructures+To+Become+The+Intellectual+Property+Enterprise+Court> (last updated Oct. 4, 2013); *How the PCC Became A Global Player*, MANAGING INTELL. PROP. (Mar. 25, 2013), <http://www.managingip.com/Article/3179044/How-the-PCC-became-a-global-player.html>.

133. See *supra* note 25 and accompanying text.

134. Christopher R. Drahozal, *Business Courts and the Future of Arbitration*, 10 CARDOZO J. CONFLICT RESOL. 491, 492 (2009).

135. See *supra* section III(B)(2).

136. See *supra* text accompanying note 130.

137. We also note that specialized courts may be less valuable if they create too much centralized decision making. See, e.g., Craig Allen Nard & John F. Duffy, *Rethinking Patent Law's Uniformity Principle*, 101 NW. U. L. REV. 1619, 1620–25 (2007) (arguing that deficits in



In addition, our findings suggest that courts should avoid adopting rules that make a judicial forum less attractive than arbitration, or at least they should proceed with a keen awareness of the consequences of their decisions. If courts adopt rules less favorable to protecting innovation, and if parties can replicate the more favorable rules in arbitration, parties will likely switch to arbitration—but at the cost of using a less preferred means of dispute resolution. The following are examples of rules that might have such an effect.

- Court decisions refusing to enforce or giving only limited effect to specific performance clauses. Although some courts give full effect to specific performance clauses,¹³⁸ others do not, requiring the party seeking injunctive relief nonetheless to prove that it will likely suffer irreparable harm.¹³⁹ This disagreement has taken on renewed significance in the wake of the U.S. Supreme Court's decision in *eBay, Inc. v. MercExchange, L.L.C.*¹⁴⁰ *eBay* involved a patent infringement case in which the Federal Circuit employed a presumption of irreparable harm.¹⁴¹ The Supreme Court rejected the use of the presumption in this context, holding that the party seeking injunctive relief must

decisions of the Federal Circuit can be traced to the fact that no other U.S. courts compete with it in deciding cases); John M. Golden, *The Supreme Court as "Prime Percolator": A Prescription for Appellate Review of Questions in Patent Law*, 56 UCLA L. REV. 657, 660–61 (2009) (same). Here, we contemplate the possibility of multiple specialized courts available to the parties.

138. See, e.g., *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208, 1226 (Del. 2012) (explaining that Delaware "courts have long held that 'contractual stipulations as to irreparable harm alone suffice to establish that element for the purpose of issuing . . . injunctive relief'").

139. See, e.g., *Dominion Video Satellite, Inc. v. EchoStar Satellite Corp.*, 356 F.3d 1256, 1264 (10th Cir. 2004) (refusing to make findings of irreparable harm based solely on the breach of an exclusivity provision); *Smith, Bucklin & Assocs., Inc. v. Sonntag*, 83 F.3d 476, 478, 481 (D.C. Cir. 1996) (stating that a noncompete contractual provision alone is insufficient to show irreparable harm); *Baker's Aid v. Hussmann Foodservice Co.*, 830 F.2d 13, 16 (2d Cir. 1987) (same); *Riverside Publ'g Co. v. Mercer Publ'g LLC*, No. C11-1249RAJ, 2011 WL 3420421, at *8 (W.D. Wash. Aug. 4, 2011) ("giv[ing] little weight to the clause in the Settlement Agreement that pre-declares that any breach of the Agreement will result in irreparable harm" and holding that the clause "does not relieve Riverside of its obligation to demonstrate irreparable harm"); see also RESTATEMENT (SECOND) OF CONTRACTS § 359 cmt. a (1981) ("Because the availability of equitable relief was historically viewed as a matter of jurisdiction, the parties cannot vary by agreement the requirement of inadequacy of damages, although a court may take appropriate notice of facts recited in their contract."); 1 COMMERCIAL CONTRACTS: STRATEGIES FOR DRAFTING & NEGOTIATING § 11.06[A], at 11-37 (Vladimir R. Rossman & Morton Moskin eds., 2d ed. 2013) ("Parties may include a clause providing for the remedy of specific performance in their contract. However, whether a court will honor that contract provision will depend on the jurisdiction."); Frederick A. Brodie & Nathan R. Smith, *The False Promise of Injunction Clauses*, MANAGING INTELL. PROP., May 2009, at 92, 94 ("The net result: contract language cannot create a right to injunctive relief when an injunction would otherwise be inappropriate.").

140. 547 U.S. 388 (2006).

141. *Id.* at 393–94.

prove irreparable harm through the factors traditionally considered in this context.¹⁴² Since *eBay*, lower courts have applied the Court's reasoning to a broad array of contractual and intellectual property contexts.¹⁴³ In all of these contexts, then, the question arises whether a moving party must prove irreparable harm even in the face of a contract clause that states that the nonmoving party concedes that irreparable harm would result. Given that arbitrators are not bound to award the same remedies that courts would award in the same circumstances, an arbitrator may be more likely to enforce a specific performance clause than would a court. And if an arbitrator did so, a court would almost certainly enforce the resulting arbitral award.¹⁴⁴ However, the consequent delay (in the context of provisional relief), the need for possible *ex post* court enforcement, and the uncertainty regarding court enforcement can all impose significant costs on the party needing protection.

- Court restrictions on the ability of parties to contract for damages (in addition to or in lieu of injunctive relief). Given the difficulty of proving damages for breaches of intellectual property rights,¹⁴⁵ parties might wish to specify a dollar value of harm in the event of certain contract breaches. This contracting technique might be especially valuable to parties who contemplate degradation of a trademark or limited unauthorized use of copyrighted or patented materials after the expiration of a contract term. Courts vary in their attitude toward when liquidated damages are "reasonable."¹⁴⁶ Moreover, in the context of

142. *Id.* at 394.

143. See Ronald T. Coleman Jr. et al., *Applicability of the Presumption of Irreparable Harm After eBay*, 32 FRANCHISE L.J. 3, 4–9 (2012) (discussing how lower federal courts have interpreted *eBay* in the context of other intellectual property fields and specifically in the context of franchise litigation); Mark P. Gergen et al., *The Supreme Court's Accidental Revolution? The Test for Permanent Injunctions*, 112 COLUM. L. REV. 203, 214–15 (2012) (noting how lower federal courts have applied *eBay* to subject matter as diverse as federal constitutional law and state tort law).

144. EDWARD YORIO & STEVE THEL, CONTRACT ENFORCEMENT: SPECIFIC PERFORMANCE AND INJUNCTIONS § 19.4, at 19-14 to -18 (2d ed. Supp. 2013).

145. See *supra* notes 35–36 and accompanying text.

146. On the reasonableness standard and applicable factors, see U.C.C. § 2-718 (2011); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981). On differing approaches to the enforcement of liquidated damages clauses, see Ian R. Macneil, *Power of Contract and Agreed Remedies*, 47 CORNELL L.Q. 495, 504–09 (1962) (surveying general differences); Douglas R. Hafer & Logan W. Simmons, *Lost Future Royalties: Lessons From Recent Decisions*, 31 FRANCHISE L.J. 150, 154–55 (2012) (discussing different perspectives on the enforceability of liquidated damages provisions to cover lost future royalties after termination of a franchise agreement).

covenants not to compete, courts differ in the extent to which liquidated damages provisions¹⁴⁷ are enforceable in the event of a breach of the covenant.¹⁴⁸

- Rules treating the enforceability of contract provisions attempting to circumvent the impact of the U.S. Supreme Court's ruling in *MedImmune, Inc. v. Genentech, Inc.*¹⁴⁹ In *Genentech*, the Court ruled that a licensee under a currently effective license agreement had standing to bring a declaratory judgment action challenging the validity of the patent.¹⁵⁰ Prior to *Genentech*, many thought such suits were not permitted unless the licensee first repudiated the agreement.¹⁵¹ In the aftermath of the opinion, questions have arisen regarding the extent to which licensors can contract around the opinion to effectively defeat patent validity challenges by current licensees.¹⁵² Examples include the enforceability of agreements that expressly forbid the licensee to challenge the patent as well as contract provisions that cancel or change the terms of contracts in the event that the licensee brings suit.¹⁵³

The Second Circuit has recently held that pre-litigation agreements prohibiting a licensee from challenging a patent's validity are void as against public policy.¹⁵⁴ The policy concern includes ensuring that there is a venue available for an effective challenge to an invalid patent.¹⁵⁵

147. Liquidated damages are common contractual remedies for breach of a noncompetition clause. *Blase Indus. Corp. v. Anorad Corp.*, 442 F.3d 235, 238 (5th Cir. 2006).

148. Some courts hostile to specific enforcement of covenants not to compete are similarly hostile to liquidated damages clauses for breach of the covenant. *See, e.g.*, *Cherry, Bekaert & Holland v. Brown*, 582 So. 2d 502, 505–06 (Ala. 1991) (holding that what amounted to a noncompete clause in a partnership agreement was unenforceable in an action for liquidated damages against professionals under Alabama law); *Junkin v. Ne. Ark. Internal Med. Clinic*, 42 S.W.3d 432, 437–38 (Ark. 2001) (expressing similar concerns). Others see enforcement of liquidated damages provisions as a compromise means for enabling an employer or franchisor to protect its investments. *Howard v. Babcock*, 863 P.2d 150, 154 (Cal. 1993); Robert W. Emerson, *Franchising Covenants Against Competition*, 80 IOWA L. REV. 1049, 1098–1100 (1995).

149. 549 U.S. 118 (2007).

150. *Id.* at 137.

151. Repudiating licensees were permitted to challenge a patent's validity after *Lear, Inc. v. Adkins*, 395 U.S. 653, 668–71 (1969) (rejecting the doctrine of licensee estoppel—that a licensee operating under a license agreement could not challenge the validity of the licensor's patent—as being inconsistent with federal policy).

152. For a discussion of these issues, see generally Alfred C. Server & Peter Singleton, *Licensee Patent Validity Challenges Following MedImmune: Implications for Patent Licensing*, 3 HASTINGS SCI. & TECH. L.J. 243 (2011).

153. *Id.* at 403–36.

154. *Rates Tech. Inc. v. Speakeasy, Inc.*, 685 F.3d 163, 172 (2d Cir. 2012).

155. *Id.* at 171.

Given the social costs of the monopoly right embedded in a patent,¹⁵⁶ it does make sense for courts to protect third parties where necessary. On the other hand, unduly restrictive approaches could drive parties to arbitration and away from courts. A compromise position may be worth serious consideration here.

- Rules that limit the duration of the enforceability of provisions that apply after the expiration of the contract—i.e., in the context of trade secret protections. Consider for example, noncompete clauses, under which an employee or purchaser of a business agrees not to work for or operate a competing business for some period of time after the contract period.¹⁵⁷ Not all states will enforce these provisions in the context of employment,¹⁵⁸ and as the California CEO employment contracts indicate, this legal rule influences party demand for arbitration. The same could be true for states that enforce the provisions only if the restrictions apply for a short period of time. States often will enforce such provisions if reasonable in geographic scope and duration,¹⁵⁹ but the critical question is what counts as “reasonable.”
- Uncertainties due to Federal Circuit review of claim construction rulings. The Federal Circuit applies a *de novo* standard for reviewing district court rulings on claim construction in patent cases,¹⁶⁰ resulting in a high reversal rate (historically, at least) and much duplication of cost and effort.¹⁶¹ By comparison, the grounds for reviewing arbitral awards are much more limited, with little or no court review of the merits of the arbitrator’s award.¹⁶² Accordingly,

156. LANDES & POSNER, *supra* note 108, at 300.

157. Kobayashi & Ribstein, *supra* note 126, at 530.

158. *Id.*

159. 6 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 13:5, at 197 (4th ed. 2009).

160. *Cybor Corp. v. FAS Techs., Inc.*, 138 F.3d 1448, 1456 (Fed. Cir. 1998) (“[A]s a purely legal question, we review claim construction *de novo* on appeal including any allegedly fact-based questions relating to claim construction.”).

161. Christian A. Chu, *Empirical Analysis of the Federal Circuit’s Claim Construction Trends*, 16 BERKELEY TECH. L.J. 1075, 1104 (2001); Kimberly A. Moore, *Markman Eight Years Later: Is Claim Construction More Predictable?*, 9 LEWIS & CLARK L. REV. 231, 233 (2005); Michael Saunders, *A Survey of Post-Phillips Claim Construction Cases*, 22 BERKELEY TECH. L.J. 215, 232–34 (2007); Andrew T. Zidel, *Comment, Patent Claim Construction in the Trial Courts: A Study Showing the Need for Clear Guidance from the Federal Circuit*, 33 SETON HALL L. REV. 711, 745–46 (2003).

162. 9 U.S.C. § 10 (2012). Some courts review awards for manifest disregard of the law (i.e., the arbitrators knowingly refused to follow the law in making the award), but other courts have rejected the availability even of that ground for review of the merits. See *Wachovia Sec., LLC v.*

commentators have argued that arbitrating claim construction “significantly reduces the risk that the parties will have to retry infringement and validity issues because of erroneous claim construction.”¹⁶³ A recent empirical study has found that the reversal rate in claim construction cases has declined significantly even without any change in standard,¹⁶⁴ making arbitration less attractive than it was previously. Although the Federal Circuit recently reaffirmed its *de novo* standard of review en banc,¹⁶⁵ the Supreme Court subsequently granted review on the issue,¹⁶⁶ making it uncertain whether this benefit of arbitration will persist.

V. Conclusion

Contract negotiation and drafting and party preferences for dispute resolution differ in the context of innovation compared to other commercial environments. To foster and protect innovation, industry norms, pragmatic compromise, and informal, non-legal dispute resolution often give way to formal legal representation, reliance on contract documents, and, where necessary, court enforcement of the parties’ bargain. Through a study of several different types of business contracts, including technology contracts, joint-venture agreements, franchise agreements, and CEO employment agreements, we show that a clear majority of U.S. contracting parties opt for courts rather than arbitration to protect at least some of their innovation and that, although this preference appears to be greatest for patent protection, it seems to persist for a wide variety of intellectual property. Although we cannot fully recreate the motivation of the parties,

Brand, 671 F.3d 472, 481 & nn.6–7 (4th Cir. 2012) (discussing the differing interpretations taken by circuit courts).

163. Stephen P. Gilbert, *Arbitrating to Avoid the Markman Do-Over*, DISP. RESOL. J., Aug.–Oct. 2006, at 1, 3.

164. See J. Jonas Anderson & Peter S. Menell, *Informal Deference: A Historical, Empirical, and Normative Analysis of Patent Claim Construction*, 108 NW. U. L. REV. 1 (2014). Analyzing the Federal Circuit’s claim construction reversal rate, Anderson & Menell found:

The data show that the claim construction reversal rate has dropped significantly since the [Federal Circuit’s 2005] *Phillips* decision: from 38.6% to 25.6% on a per-claim-term basis. The reversal rate on a per-case basis (i.e., percentage of cases with at least one reversed claim term) has fallen from 41.8% prior to *Phillips* to 31.6% following the decision. During 2009, the reversal rate dipped to 16.5%. The reversal rate for 2011 was 20.4%.

Id.

165. *Lighting Ballast Control LLC v. Philips Elecs. N. Am. Corp.*, 744 F.3d 1272, 1276–77 (Fed. Cir. 2014) (en banc) (“[W]e apply the principles of *stare decisis*, and confirm the *Cybor* standard of *de novo* review of claim construction, whereby the scope of the patent grant is reviewed as a matter of law.”).

166. *Teva Pharm. USA, Inc. v. Sandoz, Inc.*, 723 F.3d 1363 (Fed. Cir. 2013), *cert. granted*, 82 U.S.L.W. 3566 (U.S. Mar. 31, 2014) (No. 13-854).

the preference for courts seems motivated largely, though probably not exclusively, by the perception that courts are more effective venues for obtaining property-type protections, including injunctive relief.

Our contracts also provide some evidence that party preference for courts is contingent on both the quality of the court system and the ability of the parties to obtain court enforcement of their contractual protections. No doubt the legal rules that apply to the protection of innovation must take into account the needs of society as well as the parties to the contract. Nevertheless, we argue that states must give very careful thought to the rules that they craft for the protection of innovation, at least where they interface with contract principles. For better or worse, parties are good at contracting around undesirable legal rules, but those efforts come at the cost of forcing them into inferior forums for the protection of their rights.