It's Not Esoteric: Absent Ambiguity, Plain Contractual Language Governs

Article By:

Jenny Chen, Ph.D.

Rudimentary principles of contract law stipulate that words in a contract that are plain and free from ambiguity must be understood in their usual and ordinary sense. Applying such principles, the US Court of Appeals for the First Circuit vacated a district court's damages award of more than $1 million under a patent license agreement, finding that the release clause in a settlement agreement wiped out the licensee's obligation to pay royalties and sublicense fees for use and sale that occurred before the effective date of release. *The General Hospital Corporation; Dana-Farber Cancer Institute, Inc. v. Esoterix Genetic Laboratories, LLC, Laboratory Corporation of America Holdings*, Case Nos. 20-2126; -2149 (1st Cir. Oct. 21, 2021) (Selya, J.)

BACKGROUND

The plaintiff hospitals own several diagnostic patents, and Laboratory Corporation of America Holdings (LabCorp) and its subsidiary, Esoterix Genetic Laboratories, are licensee to the patents. Under the master license agreement, the licensee is obligated to pay fees to the hospitals, including royalties and sublicensee incomes.

In 2014, Esoterix settled a lawsuit against QIAGEN in association with a sublicense agreement concerning the diagnostic patents. LabCorp and Esoterix agreed to pay a portion of the settlement amount paid by QIAGEN to the hospitals. The settlement agreement included a broad release clause under which the hospitals released Esoterix from "any and all" obligations, "known or unknown," that may have arisen out of the patent rights or the license before the effective date (June 27, 2017), including "payment of any past royalties or other fees pursuant to the [license]."

A semi-annual reporting period under the license agreement was due on June 30, 2017. Esoterix took the position that all royalties and sublicense income prior to June 27, 2017, were released, and thus only reported revenue and royalty information for the period of June 28 – 30, 2017. The hospitals sued to recover sublicense fees from QIAGEN to Esoterix. The district court found that Esoterix had not been released from its payment obligation for use and sales occurring before June 27, 2017, on the ground that Esoterix's payment obligation had not originated until the payment deadline, which fell after the effective date of release. Esoterix appealed.

FIRST CIRCUIT DECISIONS

The First Circuit disagreed with the district court and concluded that the terms of the release agreement and the license agreement did not indicate that Esoterix's obligation arose when the payments became due and payable (*i.e.*, after the effective date of the release).

Following the Massachusetts law in accordance with the choice-of-law provision in the agreements, the First Circuit applied the principle that the plain meaning of the agreements governs, absent ambiguous provisions. The Court decided that the release agreement released Esoterix's obligations in connection with the underlying license agreement that may have arisen before the effective date. Taking into consideration the royalty and sublicensing fee provisions of the license agreement, the Court further decided that Esoterix's financial obligation under the license agreement, including royalties, and sublicense income, arose upon its sales and receipt of sublicensing income, which originated before the effective date, rather than when the payments become due and payable.

The First Circuit also rejected the hospitals' argument that the Court should consider the circumstances surrounding the settlement on the ground that examination of extrinsic evidence was improper since the terms of the release agreement were neither vague nor ambiguous.

The First Circuit, therefore, vacated the judgment in favor of the hospitals as to the breach of contact claim.

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