

Microsoft Corp. v. Timeline Inc.

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Court of Appeals Division I

State of Washington

Opinion Information Sheet

Docket Number: 47888-5-1

Title of Case: Microsoft Corporation, Respondent

v.

Timeline Inc., Appellant

File Date: 03/04/2002

SOURCE OF APPEAL

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Docket No: 99-2-16323-1

Judgment or order under review

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Judge signing: Hon. Stephen G. Scott

JUDGES

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IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

MICROSOFT CORPORATION,) NO. 47888-5-I
a Washington corporation,)

) DIVISION ONE

Respondent,))

v.))TIMELINE, INC.,

) Unpublished Opinion

a Washington corporation,)

) FILED: Appellant.

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COLEMAN, J. Under the 'context rule,' extrinsic evidence may be considered to show what the parties to a written contract meant by the words they used, but not for the purpose of adding to, modifying, or contradicting what the parties have written. In this case, Timeline, Inc. and Microsoft Corporation dispute the scope of a patent licensing agreement. We reverse because extrinsic evidence was improperly used to contradict or subtract terms of the written agreement.

FACTS

Timeline sells computer software that takes data from one database and rearranges it in a new database that makes the creation of reports and analysis of the data easier. Timeline patented a computer system that allows the user to automatically retrieve data that may be in different formats from one or more different sources. Microsoft had previously developed SQL Server, a software product designed to manage large databases

for businesses. In early 1999, Microsoft released a new version of SQL Server with new analysis and reporting functions. Shortly after this new version was released, Timeline and Microsoft began discussing the possibility that the new functions infringed Timeline's patent. Microsoft at first asserted that it had not infringed the patent and that Microsoft owned the disputed patent. Eventually, however, the two companies negotiated an agreement in which Microsoft agreed to purchase a license to use the patented technique.

The Negotiations

On April 13, 1999, Timeline CEO Charles Osenbaugh met with Microsoft's attorneys. The parties dispute the nature of the discussions and the scope of the license discussed at the meeting. Microsoft alleges that it made it clear to Timeline that any licensing agreement would have to protect Microsoft's customers. SQL Server is a program designed to be modified by Microsoft users by additional programming. Thus, Microsoft sought an agreement that would allow modification of its product by its customers without patent liability. The trial court found that Microsoft had consistently maintained this position throughout the negotiations and that this concern was communicated to Timeline. Osenbaugh testified that his understanding of Microsoft's April 13 proposal was that the proposed agreement would not protect any customer adding code or product that was a 'step in the process' of patent infringement. Osenbaugh also testified that the majority of third-party products that added features to SQL Server

would be protected under such an agreement because the majority of added code did not infringe an element of the patent.

No agreement was reached at the April 13 meeting, but Osenbaugh said he would consult with his attorneys. Soon thereafter, Osenbaugh contacted Microsoft's attorneys and asked them to outline their proposal in a letter. Microsoft e-mailed Osenbaugh two documents: a 'brief outline' of Microsoft's proposal and 'proposed text' of the agreement.

The 'brief outline' described the license as follows:

2)Timeline grants Microsoft a non-exclusive license to the '511 patent for SQL Server and all other Microsoft products.

a)The license would cover use s by customers, [independent software vendors], end users, etc.

b)The license would not cover customers' add-on products or technology that includes additional features or functionality not provided by Microsoft products.

Ex. 15.

The "proposed text" provided:

The license granted herein does not include the right for Microsoft to grant sublicenses to the Licensed Patents except to the extent necessary to: (1) enable Microsoft's Licensees to manufacture, use, sell, import, lease, license, reproduce, distribute or otherwise transfer Microsoft

Products as designed, and (2) enable independent software vendors to use Microsoft Technology to develop, distribute and sell products which use such technology provided or exposed by Microsoft Products.

Ex. 1.

On April 23, Osenbaugh told Microsoft 'he thought they were agreed on structure and where they were drawing the line.' The trial court found that '{a}t this point it is clear that the structure and line the parties agreed on was that which, according to the Microsoft witnesses, Microsoft proposed at the April 13 meeting.'

Drafting of the Agreement

The parties then exchanged several drafts of the proposed written agreement. Microsoft sent a draft with language that mirrored its first written proposal. Timeline countered with a draft that deleted clause (2) of the above language and added a second sentence to paragraph 2.2 which was very similar to that which appears in the final agreement:

No license is granted herein to expressly or impliedly sublicense any person or entity to add or to use any code, features, products or services to or in conjunction with any Licensed Product or any Other Product in a way that would constitute, facilitate or support an infringement of any Licensed Patent.

Ex. 20. The trial court found that this proposal was 'consistent with the position {Timeline} has taken in this litigation.'

On May 24, Microsoft proposed another revised draft, stating it could not agree with Timeline's changes. The trial court again found this draft to be consistent with the position Microsoft took at trial regarding the scope of the license. Paragraph 2.2 of the revised draft contained the following language:

Timeline hereby further grants to Microsoft, and its Subsidiaries and Affiliates, a limited right to grant sublicenses of the license granted to the Licensed Patents under Section 2.1 only to Microsoft's Licensees but only for the manufacture, use, sale, license, importation, lease or other distribution or transfer of Licensed Products and for the formation, use, sale, license, importation, lease or other distribution or transfer of any combination which includes a Licensed Product, provided, however, that such sublicensing rights shall not cover or extend to any third party product in such combination which third party product itself directly infringes or contributorily infringes a Licensed Patent. No other sublicensing rights are granted.

Ex. 22. The first sentence of this paragraph was virtually unchanged in the final agreement.

The second sentence, however, was replaced after a May 26 conference call in which Timeline expressed concern that the second sentence was insufficiently specific.

Later that day, after the conference call, Timeline sent an e-mail to Microsoft, proposing the following additional language:

1.7 'Infringement' shall include direct infringement, contributory infringement, and inducement to infringe.

2.3 No license is granted herein to expressly or impliedly sublicense any person or entity to add any code or product to or in combination with any Licensed Product in a way that constitutes Infringement.

3.3 No release, acquit, covenant not to sue or discharge is granted herein to any Microsoft Licensee to add any code or product to or in combination with any Licensed Product in a way that constitutes Infringement.

Ex. 23. The parties eventually adopted all of the proposals; the proposed paragraph 2.3 became the last sentence of paragraph 2.2 of the final agreement.

After Microsoft received the above proposals, the parties had another telephone conversation to discuss them. The parties dispute the substance of the conversation. Microsoft's attorney Bart Eppenauer testified that he asked Osenbaugh the purpose of the new language, because it seemed to him to say essentially the same thing as the first sentence of paragraph 2.2 in Microsoft's draft. Osenbaugh responded that there 'really wasn't a difference' but Timeline 'just preferred' the new language. The trial court found that this conversation occurred as Eppenauer recalled it.

The court further found:

{M}ore probably than not Mr. Osenbaugh was attempting to 'clarify' that companies already infringing the . . . patent independently could not get

off the hook by combining their own products with Microsoft's in such a way that Microsoft's product then performed one or more steps of the infringing process. If, on the other hand, Timeline was attempting to add language that would result in the extremely limited license it now seeks from this court, it attempted to do so without adequately communicating the intent to Microsoft and the attempt, therefore, fails.

In the final version of the written licensing agreement, the parties used the following language to describe the license granted to Microsoft by Timeline (the underlined portion was the chief source of the dispute between the parties):

2. License

2.1 Timeline hereby grants to Microsoft, and its Subsidiaries and Affiliates and Microsoft Licensees, a non-exclusive, perpetual, irrevocable, fully paid, worldwide right and license, under the Licensed Patents, to make, have made, use, sell, import, lease, license, reproduce, distribute, transfer or commercially exploit the Licensed Products.

2.2 Timeline hereby further grants to Microsoft, and its Subsidiaries and Affiliates, a limited right to grant sublicenses of the license granted to the Licensed Patents under Section 2.1 only to Microsoft's Licensees but only for the manufacture, use, sale, license, importation, lease or other distribution or transfer of Licensed Products and for the formation, use, sale, license, importation, lease or other distribution or transfer of any combination which includes a Licensed Product, provided, however, that such

sublicensing rights shall not cover or extend to any third party product in such combination if that third party product itself directly or contributorily infringes a Licensed Patent. No license is granted herein to expressly or impliedly sublicense any person or entity to add any software code or software product to or in combination with any Licensed Product in a way that constitutes Infringement of a Licensed Patent.

Ex. 1 (emphasis added). In addition, the agreement contains a 'merger' clause, which states that the writing 'sets forth the entire agreement and understanding between the parties' and 'merges all prior discussions between them.' Ex. 1, 12.1.

Sometime after the parties signed the agreement, Timeline contacted several Microsoft customers in an attempt to negotiate separate licensing agreements. Microsoft then initiated this action for declaratory judgment. Microsoft argued that the above language allows Microsoft customers to add code and software to Microsoft products, even if the resulting combination infringes Timeline's patent, as long as the code or software added does not independently infringe Timeline's patent. Timeline claimed that the agreement also prohibited Microsoft customers from combining their own code or software with Microsoft products if the added code performed a step in the patented process and the resulting combination infringed Timeline's patent.

Timeline moved for summary judgment, claiming that Microsoft's interpretation of the agreement was contrary to the unambiguous terms of the contract. The trial court denied the motion, ruling that the contract

on its face was capable of either interpretation given it by the parties. Accordingly, the trial court determined that extrinsic evidence was necessary to ascertain the parties' intent. The matter proceeded to a bench trial.

After considering evidence of the above negotiations, drafting history, and testimony regarding the nature and purpose of SQL Server, the trial court concluded that the agreement gave Microsoft the right to sublicense its customers to add code or other software products, as long as the added programming does not itself independently infringe Timeline's patent. The court further ruled:

In any infringement analysis of a combination of third-party code or software with SQL Server or any other Licensed Product (as that phrase is defined in the License Agreement), steps performed by the Licensed Products must be entirely disregarded.

This appeal followed.

DISCUSSION

Interpretation of a contract is a mixed question of law and fact. Where the trial court's interpretation hinges on the credibility of conflicting evidence, we will uphold the court's factual findings as long as they are supported by substantial evidence in the record. See *Berg v. Hudesman*, 115 Wn.2d 657, 668, 801 P.2d 222 (1990) (adopting Restatement (Second) of Contracts sec. 212 (1981)). But the question of whether a

contract is ambiguous is a legal question for the court, and we review that determination de novo. *Schwab v. City of Seattle*, 64 Wn. App. 742, 751, 826 P.2d 1089 (1992). We also conduct de novo review to determine whether the trial court's factual findings support its legal construction of the contract. E.g., *Griffith v. Centex Real Estate Corp.*, 93 Wn. App. 202, 214, 969 P.2d 486 (1998) (whether party committed particular act is question of fact; whether act violated statute is question of law).

When interpreting a contract, our primary goal is to determine the intent of the parties. *U.S. Life Credit Life Ins. Co. v. Williams*, 129 Wn.2d 565, 569, 919 P.2d 594 (1996). We determine intent by the objective manifestations of the agreement rather than subjective intent of either party. *Max L. Wells Trust by Horning v. Grand Cent. Sauna & Hot Tub Co. of Seattle*, 62 Wn. App. 593, 602, 815 P.2d 284 (1991). This means that where, as here, the parties have put their agreement in writing and have indicated that the writing is the final and complete agreement of the parties, we must discern the parties' intent from the language of the writing. A voluntary signatory is generally bound to a signed contract even if ignorant of its terms. *Grand Cent.*, 62 Wn. App. at 602. And under the parol evidence rule, extrinsic evidence is not admissible for the purpose of adding to, modifying, or contradicting the terms of a final and integrated written contract, in the absence of fraud, accident, or mistake. See *Berg*, 115 Wn.2d at 669. Because the meaning of language can rarely be determined without reference to the context in which the language is used, the Supreme Court in *Berg* held that a trial court may consider extrinsic evidence to determine the meaning parties have assigned to particular

terms. But the Berg court qualified its holding by reaffirming the following principle of contract interpretation:

'Such evidence, however, is admitted, not for the purpose of importing into a writing an intention not expressed therein, but with the view of elucidating the meaning of the words employed. Evidence of this character is admitted for the purpose of aiding in the interpretation what is in the instrument, and not for the purpose of showing intention independent of the instrument. It is the duty of the court to declare the meaning of what is written, and not what was intended to be written.'

Berg, 115 Wn.2d at 669 (quoting *J.W. Seavey Hop Corp. of Portland, Or. v. Pollock*, 20 Wn.2d 337, 348-49, 147 P.2d 310 (1944) (emphasis added)).

Timeline argues that the trial court erred because it used extrinsic evidence to contradict portions of the written licensing agreement. We agree. The trial court found that the parties intended to draft a sublicensing provision that would protect any Microsoft licensee adding code or software to Microsoft products, as long as that code or software, standing alone, did not infringe Timeline's patent. This interpretation, however, contradicts the language the parties agreed upon in paragraph 2.2 of the agreement:

Timeline hereby further grants to Microsoft, and its Subsidiaries and Affiliates, a limited right to grant sublicenses of the license granted to the Licensed Patents under Section 2.1 only to Microsoft's Licensees but only for the manufacture, use, sale, license, importation, lease or other distribution or transfer of Licensed Products and for the formation, use,

sale, license, importation, lease or other distribution or transfer of any combination which includes a Licensed Product, provided, however, that such sublicensing rights shall not cover or extend to any third party product in such combination if that third party product itself directly infringes or contributorily infringes a Licensed Patent. No license is granted herein to expressly or impliedly sublicense any person or entity to add any software code or software product to or in combination with any Licensed Product in a way that constitutes Infringement of a Licensed Patent.

(Emphasis added.) This portion of the agreement expressly denies sublicensing protection to anyone who adds code or product 'in a way that constitutes Infringement of a Licensed Patent.' 'Infringement' is defined within the agreement as including direct or contributory infringement.¹

Microsoft argues that the second sentence of paragraph 2.2 was intended merely to restate the first sentence. But it clearly does not restate the first sentence, and neither Microsoft nor the trial court has explained how the words in the second sentence could be so interpreted. Try as we might, it is impossible to reconcile the wording of the two sentences with Microsoft's proposed construction.

Microsoft reasons that because Timeline's president and Microsoft's attorney allegedly agreed that the first and last sentences meant the same thing, Timeline is bound by that interpretation. See Restatement (Second) of Contracts sec. 201(1) (1981) ('Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning.') The 'meaning' of an agreement, however,

must be determined according to the words used. Unwritten understandings may be used to define those words, but not to replace the language actually written with what was intended to be written. Berg, 115 Wn.2d at 669; see also *In re Marriage of Schweitzer*, 132 Wn.2d 318, 326, 937 P.2d 1062 (1997) (holding community property agreement effective when signed even though both parties intended it to take effect at death of spouse).

Further, even if we disregard the second sentence, Microsoft's interpretation would make the reference to contributory infringement in the first sentence meaningless. The proviso in the first sentence denies sublicensing protection to anyone who adds code that itself 'directly infringes' or 'contributorily infringes' the patent. A contributory infringer is one who sells a material component of a patent, knowing that it will be combined with other products and that the resulting combination will directly infringe a patent. See 35 U.S.C. sec. 271(c). Microsoft argues that because there can be no contributory infringement without a direct infringement, and because a licensed use is not an infringing use, a sublicensee under the agreement cannot contributorily infringe as a result of a combination with Microsoft products. But by this reasoning, there would be no way to add code that would constitute contributory infringement.

We agree with Timeline that the only way to harmonize the first and second sentences of paragraph 2.2 is to read the second sentence as a clarification of how a Microsoft licensee 'contributorily infringes' Timeline's patent: by adding code or software 'in a way that constitutes {direct or contributory} Infringement of a Licensed Patent.' If, on the

other hand, we read the agreement as Microsoft suggests, we must interpret the reference to contributory infringement in the first sentence as meaningless surplusage and strike the second sentence altogether.

Although courts are entitled to consider extrinsic evidence in determining what the parties meant by certain terms in the agreement, it was impermissible for the trial court to use extrinsic evidence to contradict or strike portions of the written agreement. See *Schweitzer*, 132 Wn.2d at 326 (holding court erred when it used parol evidence to subtract entire section from agreement and give it no effect). In *Schweitzer*, a husband and wife signed a form community property agreement. At dissolution, Mrs. Schweitzer claimed that the agreement converted all property to community property upon signing, while her husband argued that the agreement was to take effect only upon the death of one spouse. Although the trial court found that both parties intended the agreement to function solely as an estate planning document, the Supreme Court held that the parties should be held to the entire agreement, which unambiguously converted all property to community property at the time of execution.

Microsoft argues that *Schweitzer* is distinguishable because in that case, there was no evidence that the parties communicated with each other regarding the meaning of the words used; the parol evidence that was excluded concerned the parties' unexpressed, subjective intentions with regard to the instrument. See *Schweitzer*, 132 Wn.2d at 322. It is true that here, unlike *Schweitzer*, the court found that the parties expressed mutual subjective intentions to each other regarding the scope of the sublicense in prior negotiations. But the general rule as enunciated in

Schweitzer is equally applicable here: extrinsic evidence should be used 'only to elucidate the meaning of the words of a contract, and 'not for the purpose of showing intention independent of the instrument.'" Schweitzer, 132 Wn.2d at 327 (quoting Berg, 115 Wn.2d at 669). Here, as in Schweitzer, one party claims it intended the contract to have a legal effect that is different than that specified by the writing. And here, as in Schweitzer, extrinsic evidence, although properly considered in determining the meaning of particular terms, should not have been used to contradict or nullify select portions of the agreement.

Microsoft also argues that the agreement is not commercially reasonable under Timeline's interpretation. 'Where one construction would make a contract unreasonable, and another, equally consistent with its language, would make it reasonable, the latter more rational construction must prevail.' *Byrne v. Ackerlund*, 108 Wn.2d 445, 454, 739 P.2d 1138 (1987) (emphasis added). But where, as here, a party's interpretation is not consistent with the language of the writing, it is not the duty of the courts to correct what may be bad bargains, but rather to enforce an agreement as written. Both Microsoft and Timeline argue that their respective interpretations are the more commercially reasonable.² And if the trial court had been faced with two equally supportable interpretations of paragraph 2.2, its finding that Microsoft's interpretation was more commercially reasonable would support construing the agreement in Microsoft's favor. But after all the extrinsic evidence is considered, Microsoft's interpretation of paragraph 2.2 is simply not 'consistent with its language,' and therefore we must enforce the contract as written.

Byrne, 108 Wn.2d at 454.

Accordingly, we reverse the trial court's declaratory judgment and remand for entry of declaratory judgment in favor of Timeline. Our construction of the agreement does not deny sublicensing protection to all Microsoft customers who add code or combine software with SQL Server. If a Microsoft licensee adds code to SQL Server that is not a 'material part'³ of Timeline's patent, no infringement has occurred, even if the resulting combination would otherwise infringe Timeline's patent. But if the added code is a material part of Timeline's patent, and the resulting combination infringes the patent, the sublicensee has exceeded the scope of Microsoft's sublicensing rights under the agreement.

Reversed and remanded.

WE CONCUR:

¹ Contributory infringement, as defined by federal patent law, occurs when a person sells a component of a patented invention that does not itself independently infringe a patent, but constitutes a material part of the patent. 35 U.S.C. sec. 271(c). Because the material component contributes to an infringement when added to another person's product, a person who sells the component and knows it is especially made or adapted for an infringing use is guilty of contributory infringement. 35 U.S.C. sec. 271(c).

2 In this regard, it is important to note that Timeline does not seek a construction of the agreement that would make any added code an infringing use under the agreement. The trial court found that 'while it is possible to use SQL Server without adding any code or software, such use would be extremely limited.' But Timeline does not dispute that SQL Server was intended for code to be added to it. Timeline instead asserts that the majority of code added would not infringe under its interpretation of the contract, because the majority of code added is not a component of Timeline's patented process.

3 In any infringement analysis, federal patent law will control the determination of whether added code or software is a 'material part' of Timeline's patent.