

An Introduction to Intellectual Property Licensing for Technology Companies

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ABSTRACT

Intellectual property licensing is an important issue facing all technology companies. Before entering into license agreements a number of issues need to be addressed, including invention ownership, obtaining and identifying licensable subject matter, and developing a licensing strategy. There are a number of important provisions that are included in most intellectual property license agreements. These provisions include definitions, the license grant, consideration, audit rights, confidentiality, warranties, indemnification, and limitation of liability. Special licensing considerations exist relative to each type of intellectual property, and when the other party is a foreign company or a university.

Keywords: : intellectual property, licensing, copyright, patent, trade secret, trademark, agreement.

1. INTRODUCTION

Intellectual property licensing has assumed a new prominence in our economy of ideas and information. For many start up and early growth phase technology companies, intellectual property is the only asset of any substantial value. Thus, it is critically important that licensing of such intellectual property be carefully planned and executed.

The issues technology companies face in licensing intellectual property are generally the same as those faced by older economy companies, with one important exception. Many technology companies lack the processes, form documents, institutional knowledge and culture necessary for effective licensing of intellectual property. Regardless of the reasons for this condition, the results can be disastrous. Many a technology company has wasted its first generation of technology because it lacked the infrastructure necessary to protect and effectively exploit its intellectual property.

In recognition of this condition, the first portion of this paper is directed to pre-licensing considerations. These are considerations that technology companies, typically young companies, need to address in a committed and effective way to set the stage for successful protection and exploitation of their intellectual property. Ownership of intellectual property is treated in greatest detail because this is an area where technology companies often face problems. After pre-licensing considerations, this paper delves into intellectual property licensing, first on a general level, and then more specifically relative to a number of subjects.

This paper is intended as an introduction to intellectual property licensing issues that engineers, managers, executives and other individuals will encounter in their work. Because of the breadth of this topic, only the most important issues are addressed. Many relevant issues in intellectual property licensing have been omitted. Thus, this paper should be regarded as only a starting point for licensing of intellectual property and is not a substitute for obtaining advice from competent legal counsel.

2. PRE-LICENSING CONSIDERATIONS

2.1 What is licensing?

At the highest level, a license is permission to do something that the licensor can prohibit. For example, a patent owner can exclude others, among other things, from selling an invention covered by the claims of its patent. Licensing can also be viewed as the transfer of rights that are less in degree than a transfer of the entire ownership. As another example, a nonexclusive license to a copyrighted software product results in the licensee obtaining limited rights to use the software, while the licensor retains ownership and the right to license others.

2.2 Licensors need something to license

Without belaboring the obvious, licensors need to develop or otherwise obtain intellectual property before it can be licensed. For most technology companies, intellectual property flows naturally from routine business operations. However, the quantity, type and quality of intellectual property a company owns is influenced by procedures used to motivate creation of, record, evaluate and protect intellectual property. Also, licensing opportunities may exist with respect to intellectual property that companies have overlooked and intellectual property may be created specifically for the purpose of licensing.

2.2.1. Motivation, recording, evaluating and protecting intellectual property

Invention is a natural result of the work conducted in technology companies. The challenge a prospective licensor faces, however, is transferring invention from the minds of inventors to forms of intellectual property that are licensable. The term “invention” is used broadly to encompass ideas, concepts, developments, works of authorship, designs (ornamental and otherwise) and other intellectual property falling within the four broad categories of copyrights, patents, trade secrets and trademarks.

Many companies have found it useful to reward their inventors for inventions they create. They do so because inventors face an inevitable disincentive to assist in the process of obtaining licensable intellectual property due to other pressing work demands. There is a split of opinion on how the reward should be structured, whether monetary rewards are appropriate, and when the reward is paid. However, inventors must be motivated to assist in the process of generating licensable intellectual property.

Related to the issue of motivating inventors to assist with obtaining intellectual property is the need for a consistent and effective process for recording, evaluating and protecting inventions that inventors develop. Both a good process, and procedures for ensuring the process is being properly implemented, are keys for success. When inventors feel there is no meaningful process for evaluating their inventions, or the process is not implemented consistently or on a timely basis, the incentive to record and disclose inventions diminishes. A mediocre process that is implemented on a timely and consistent basis may produce more and better licensable intellectual property than a highly sophisticated process that is not implemented effectively.

2.2.2. Overlooked and unidentified intellectual property

In some cases, companies may find it useful to specifically seek out potentially licensable intellectual property from their employees and consultants. Often, inventions that could be licensable never find their way out of the minds or lab notebooks of inventors. Consequently, companies interested in licensing intellectual property should consider interviewing their employees for the purpose of identifying potentially licensable inventions.

Also, as Kevin Rivette and David Kline have so aptly pointed out in their recent book *Rembrandts in the Attic: Unlocking the Hidden Value of Patents*,¹ companies often own patents that are not being licensed, or are not being licensed as successfully as possible. By evaluating existing patent portfolios, and then considering how underutilized patents in the portfolio can be more effectively commercialized, it may be possible to generate substantial licensing revenues.

¹ K. Rivette & D. Kline, *Rembrandts In the Attic: Unlocking the Hidden Value of Patents*, Harvard Business School Press, Boston, Massachusetts (2000).

2.2.3. Developing intellectual property for licensing

While licensable intellectual property typically arises from the normal business operations of technology companies, it is also possible to develop intellectual property solely for the purpose of licensing. Through the development and use of idea laboratories, creative problem solving tools and other techniques, inventions can be created to address specific licensing opportunities. Indeed, companies such as Walker Digital Corp.² have been developed solely for the purpose of creating and licensing intellectual property.

2.3 Ownership of intellectual property being licensed

A company may have spectacular technology and its legal counsel may create an impeccable license agreement. However, if the licensor does not own the intellectual property licensed, all can be for naught. Fortunately, this problem can be substantially avoided through the use of appropriate forms and procedures, along with knowledge of what the law prescribes in the absence of any written documents. Ownership of intellectual property is dictated by the type of intellectual property at issue, and whether the creator of the intellectual property is a consultant or employee.

2.3.1. Employees

In the case of patents, the employee generally owns the patent unless he or she is contractually obligated to assign the invention to the employer. Exceptions to this rule exist when the employee was specifically hired to develop a given invention, and when fairness demands that an employee-owner, manager, executive, and in limited cases regular employee, assign the invention to the employer. Hiring an engineer to perform technical work that is not specifically defined does not generally qualify as “hired to invent.” As a general proposition, courts tend to be reluctant to obligate employees to assign patents to employers when the patent has application beyond the technical field in which the employee created the invention that is the subject of the patent.

Although employees are generally deemed the owners of patents involving inventions they create in the absence of a broad invention/patent assignment agreement, employers often receive a “shop right” in the patent. A shop right is a nonexclusive, royalty-free, irrevocable, nontransferable implied license under the patent that permits the employer to make, use and sell the patented invention created by the employee. Shop rights generally arise when the employee created the invention using the employer’s facilities, materials or equipment, with the patented invention typically being created during the employee’s conventional hours of employment.

To avoid creation of a shop right, and instead achieve complete ownership of the patent, it is important that employees be obligated to sign a general invention/patent assignment agreement as a condition of employment. If the employee is required to sign such an agreement after employment begins, the enforceability of such an agreement may be subject to challenge under certain limited circumstances based on lack of consideration.

Ownership of copyrights differs from patents. Copyrightable subject matter created by an employee in the course of his or her employment is considered a work made for hire. Employers are deemed the author, and hence owner, of works made for hire. No specific written assignment agreement is required, although such agreements are frequently used to avoid any uncertainty.

Employers are generally deemed the owners of trade secrets employees create within the scope of their ordinary employment. Nevertheless, the use of written invention assignment agreements is recommended.

The law concerning an employee’s ownership rights in trademarks they create is less developed than in the case of copyrights, patents and trade secrets. However, the rules governing ownership of trade secrets generally apply to trademarks.

Employers generally have no rights in intellectual property owned by an employee at the date the employee commences work for the employer. Exceptions to this rule exist when fairness so demands, e.g., when an employee brings in a prior invention and incorporates it in a product without the employer’s knowledge or affirmatively

² Wall Street Journal, Oct. 3, 2000, at B1.

indicates the employer is free to use the invention. Like any situation where a court bases judgment on what is fair, the outcome will turn on the facts of a given situation.

2.3.2. Consultants

Other than in the case of copyrights, the rules for ownership of intellectual property created by a consultant for a third party in the context of the consulting relationship are generally the same as those for employees, as discussed above. A review of the relevant case law suggests courts may be somewhat more inclined to find that shop rights exist in the case of work performed by a consultant than an employee. Invention ownership determinations are so fact dependant, however, it is difficult to generalize in a meaningful way as to the likelihood of a shop right being created.

Consultants own the copyrights in subject matter they create absent a written agreement obligating the consultant to assign the copyrights to the entity engaging the consultant. However, even if no such agreement is signed, the entity engaging the consultant obtains an implied license to use the copyrightable subject matter for the purpose for which the consultant was hired. Because the scope of such license will vary depending upon the facts, it is essential from the perspective of the party engaging the consultant that copyright ownership or license rights be determined in writing before the consultant begins work.

2.3.3. Third parties

In spite of the use of appropriate employee invention assignment agreements and consulting agreements, a company still may not own intellectual property created by its employees or consultants due to prior or superior ownership rights of third parties. Prior ownership rights arise when an employee or consultant provides a company with intellectual property that was first created by or for a former employer and is the subject of a prior assignment. Under certain circumstances that generally arise with consultants, a concurrent intellectual property assignment obligation to one entity can be superior to the obligation to assign to the other entity for which the employee or consultant work. For example, a university professor may be hired to provide technical advice for one company, while at the same time be conducting sponsored research in the same technical field. The professor will typically be obligated to assign to the university all inventions relating to the field of her sponsored research, regardless of whether developed in direct performance of the sponsored research or in the context of approved consulting work. Thus, even though the professor signs a consulting agreement obligating her to assign intellectual property developed for one company in the context of a consulting engagement, the university will likely have a superior invention ownership claim to the intellectual property.

There are a number of steps that can be taken at the time employees are hired and consultants are engaged to reduce the possibility of a third party ownership claim to intellectual property provided by employees or consultants. First, employees and consultants should be orally advised, and contractually bound, not to provide intellectual property owned by any third parties. Second, employees and consultants should be obligated to provide copies of all agreements with prior or concurrent employers having intellectual property assignment or license provisions. These agreements should be carefully reviewed, and employees should be thoroughly interviewed, to assess if third parties may have an ownership claim to intellectual property provided by employees and consultants. Third, while easier said than done, it is certainly preferable not to employ or engage individuals that worked previously for another company in exactly the same technical area as the one in which they will be working for your company.

2.3.4. Prior inventions by employees

On occasion employees and consultants will be motivated to provide employers with inventions they previously developed and own. Without a clear prior understanding of the employer's rights in such inventions, an employer should take appropriate steps to avoid receipt of such inventions. As with inventions to which third parties have an ownership claim, it is important to warn employees and consultants not to use or disclose inventions they own at the time employment commences. In addition, invention agreements should specifically provide that as a consequence of providing employee or consultant-owned inventions to an employer, the employee or consultant automatically grants the employer sufficiently broad rights to use the invention in connection with all its business activities.

2.4 Drafting patent claims with licensing in mind

Significant patent licensing opportunities are often lost because the claims in a patent are not constructed to cover all classes of potential infringers. For example, if a patent directed to a photonics widget only claims the widget (which for this example is assumed to be a staple article of commerce), but the widget is generally combined with another device, then significant licensing opportunities may be lost. By describing and claiming the photonics widget with the other device, then an expanded set of potential licensees may be created, i.e., those combining the widget with the other device.

While strategies for drafting claims are outside the scope of this paper, several general observations may be made. An invention should generally be claimed in higher and lower levels of assembly than the level in which it initially resides. The prior example indicates how an invention can be claimed in a higher level of assembly. Lower levels of assembly consist of components of the basic invention. Method and so-called Beauregard claims should be used whenever available in addition to apparatus, article or system claims. Further, claims of varying structure at a given level of assembly should be included. In addition, while “means for” claims are generally in disfavor due to their narrow scope, significant changes in law can occur over the 20 year term of a patent. For this and other reasons it is often desirable to include one or more “means for” claims.

2.5 Due diligence

Intellectual property licensing is certainly an area where the phrase “buyer beware” applies. In many circumstances it is not enough to merely accept the representations and warranties of the licensor. Instead, the prospective licensee should consider conducting its own due diligence. For example, a licensee may want to explore if the licensor has maintained all the licensed patents, or obtained enforceable patent assignments from all named inventors. In more limited circumstances, the licensor may want to investigate the licensee as well. For example, in an exclusive, royalty-bearing license agreement, the licensor may want to investigate the likelihood of the licensee satisfying its obligations to market and sell licensed products. Other areas to investigate include whether the licensed intellectual property can be practiced without infringing the intellectual property of third parties, whether all corporate and other internal authorizations have been obtained, and whether the license grant is consistent with other licenses granted by the licensor.

2.6 Identifying potential licensees

Companies will occasionally approach an owner of intellectual property to obtain a license. In other circumstances, potential licensees are readily apparent from routine business activities. When intellectual property licensing is a specific business objective, however, a more targeted investigation is typically required. Identifying competitors through conversations with existing customers, exploring booths at trade shows, and conducting Internet and other on-line searches are common ways to identify competitors. More sophisticated business analysis tools may also be used such as analyzing published foreign patent applications, reviewing recent technical publications by inventors of selected competitors, and reverse engineering the products of competitors, and using patent mapping software tools.

2.7 Licensing strategy

To maximize the value of licensed intellectual property it is important that a licensing strategy be developed and followed. While licensing strategies can be extremely sophisticated, even a rudimentary licensing strategy is generally better than no strategy. At a minimum issues such as term, exclusivity vs. non-exclusivity, field of use, and territory, all discussed in more detail below, need to be considered. At a somewhat more sophisticated level, licensing strategies may include matters such as how licensees are approached (e.g., gentle information letter, cease and desist letter, initiating litigation without service, etc.), and which licensees to target first (e.g., big vs. small, foreign vs. domestic).

3. ESSENTIAL ASPECTS OF LICENSE AGREEMENTS

All license agreements, regardless of type, have certain provisions in common. On the other hand, each type of intellectual property demands certain unique licensing provisions. For example, it is essential that trademark license agreements include quality control provisions, while quality control may be less relevant to certain patent licensing. The following discussion focuses on provisions that are essential aspects of license agreements for all types of

intellectual property. However, some consideration will be given to provisions that pertain to license agreements for only one type of intellectual property.

3.1 Whereas clauses and background statements

A license agreement typically begins with “whereas” clauses that lay out the intentions and motivations of the parties in entering into the agreement. These clauses can be important in later interpretation of the agreement, whether or not in the context of litigation, and so should be given careful consideration. There is sometimes a reluctance to begin a license agreement with “whereas” clauses due to the perceived stiffness and formality associated with such clauses. This concern can be substantially addressed by beginning agreements with single or multiple paragraph sections entitled “background statement” or “preliminary statement.”

3.2 Definitions

For all but the simplest license agreements, it is desirable to include a section in which key provisions in the license agreement are defined. Great care should be taken in formulating definitions, as they constitute the foundation of the license agreement. The content and number of definitions used will vary significantly as a function of the intellectual property involved, the sophistication of the agreement, licensing strategy and other factors. Several of the most common definitions used in intellectual property license agreements are considered below.

3.2.1. Field of Use

It is often desirable to define the field in which the licensed intellectual property may be used. The Field of Use may be defined relative to market sector, e.g., retail, Internet, or mail order. The Field of Use may also define the specific technical field in which the licensed intellectual property may be used. For example, separate fields of use for a patent and know-how directed to a lens design include microscopes, photolithography equipment, and telescopes. When the intellectual property is directed to a process, the field of use may define the type of process(es) in connection with which the licensed process may be used. Great opportunities for creativity clearly exist in constructing a definition for Field of Use.

3.2.2. Licensed intellectual property

The definition “Licensed Intellectual Property” captures the scope of intellectual property to which the licensee acquires rights under the license agreement. Often, the Licensed Intellectual Property is defined in a schedule attached to the license agreement that lists specific patents, trademarks or other intellectual property. In other cases, the textual definition of Licensed Intellectual Property will, itself, identify the specific intellectual property. In yet other cases, the Licensed Intellectual Property definition will describe the licensed intellectual property by making reference to other parameters such as patents issued prior to a specified date, or all patents of the licensor in a specified field. While substantial creativity may be exercised in defining Licensed Intellectual Property, it is critical that the definition be clear and definite.

Certain specific issues need to be considered for particular types of intellectual property. In the case of patents, it is generally desirable to include applications maturing from continuation, divisional, and continuation-in-part applications claiming priority on identified patents, along with extended, reissued, reexamined patents. Where trade secrets and know-how is being licensed, consideration must be given as to whether the definition of Licensed Intellectual Property will include one or more of: the content of any deliverables package, previously disclosed information, and information conveyed in connection with technical support and training. In trademark licensing, the parties should decide whether common law trademarks should be included in the definition of Licensed Intellectual Property (often referred to as “Licensed Trademarks”), or just pending trademark applications and registered trademarks. When the Licensed Intellectual Property includes copyrights, the parties should evaluate if derivative works should be included in the definition.

3.2.3. Licensed products/processes

The products and/or processes that the licensee is authorized to make, use and sell should be specifically identified. In many cases, the set of licensed products and processes is less than the set of products and processes falling within the definition of Licensed Intellectual Property. For instance, a patent directed to a VCSEL and related electronic control circuit may have claims directed to the VCSEL alone and the combination of the VCSEL and the control circuit. Even though the definition of Licensed Intellectual Property may be the same in two different license agreements, in one agreement Licensed Products may be defined as VCSELS and not the VCSEL/circuit

combination, while in the other agreement Licensed Products may be defined as the VCSEL/circuit combination and not the VCSEL alone.

3.2.4. Net sales

In license agreements featuring periodic royalties, it is common to base royalty payments on the licensee's Net Sales. In general, Net Sales are determined by deducting from gross sales items such as returns, shipping and sales and excise taxes. Licensors, in particular, need to look for loopholes licensees will exploit to reduce royalty payments. For example, care needs to be exercised in defining Net Sales when the licensee will make intra-corporate transfers of Licensed Products that would otherwise be subject to a royalty. Also, there are competing interests between licensee and licensor as to when Net Sales are deemed to occur. The licensor generally favors an early date, e.g., when products are invoiced, and the licensee generally favors a late date, e.g., when payment is received.

3.2.5. Territory

Territory definitions describe the geographic region in which the licensee enjoys the right to practice the license grant. Territory definitions can range from a room in a specified building to the entire world. The licensing strategy of the licensor and the license needs of the licensee will generally dictate the geographic scope of the Territory definition.

3.3 License Grant

The license grant is the portion of a license agreement that defines the rights the licensee obtains in the intellectual property of the licensor. There are great opportunities for creativity in drafting a license grant, as intellectual property can be "sliced up" almost any way imaginable (subject to certain antitrust/patent misuse constraints mentioned briefly below). As defined terms figure prominently in the license grant, such terms are typically drafted in connection with the drafting of the license grant. A discussion of important aspects of the license grant follows.

3.3.1. Exclusive vs. nonexclusive

If unqualified, an exclusive license grant permits only the licensee to practice the licensed intellectual property. An unqualified exclusive license is just one step removed from assignment of intellectual property. In practice, however, exclusive licenses are often qualified. These qualifications may include Field of Use, i.e., exclusive only in the Field of Use, Territory, i.e., exclusive only in the Territory, prior agreements, i.e., exclusive subject to prior license grants, and reservation of rights by the licensor to practice the licensed intellectual property.

Whether to grant an exclusive or a nonexclusive license is an essential element of a licensing strategy. However, where barriers to entry are high, e.g., developing a new pharmaceutical product, exclusive licenses may be essential. Also, in some cases a company may require an exclusive license for a term of years to develop strong brand identity. A licensor will need to weigh these and other factors in assessing whether the license grant should be exclusive or nonexclusive.

It is generally typical for an exclusive license to include minimum royalty payment obligations, irrespective of the licensee's success in commercializing the licensed intellectual property. Alternatively, an exclusive license should at least contain diligence provisions obligating the licensee to diligently pursue promotion and sale of the invention. Failure to satisfy the diligence obligations results in at least reduction to nonexclusive license status, and in many cases termination of the license grant. The diligence provisions may be styled as minimum sales in dollar or unit volumes, achievement of certain development milestones, or merely by including the obligation to use best or reasonable efforts to develop, promote and/or sell the product.

3.3.2. Rights conveyed

The rights conveyed under the license grant may be extremely limited, very inclusive, or something in between. Also, the type of intellectual property licensed will influence the rights conveyed. When the licensed intellectual property includes patents and/or trade secrets, the license grant typically includes the right to do one or more of the following: make, have made, use, offer for sale, sell and import. These rights track the rights to exclude provided in the patent statute, but are not exclusive. It is common to include in license grants the right to "lease and otherwise dispose of" the licensed products. Other rights may be conveyed as well. Because these rights are separable, one

licensee may be granted the right to make a product for its own use, but not sell the product, while another licensee may enjoy the right to sell the product, but not make it.

In the case of copyrights, the rights conveyed vary more widely than in the case of patents due to the large range of subject matter protected by copyright. Often, the copyright grant includes one or more of the exclusive rights specified by copyright statute: reproduce, distribute, publicly display, publicly perform, prepare derivative works, and transmit digital sound recordings.

A license grant to trademarks typically permits the licensee to use the mark to identify specified goods or services.

3.4 Sublicensing

An exclusive license often includes the right to sublicense. Absent an express authorization to sublicense, a licensee does not enjoy sublicense rights. Thus, if sublicense rights are desired by the licensee, then the license agreement should specifically address the right to sublicense. Sublicense rights are not typically granted in a nonexclusive license agreement, although exceptions exist.

It is important to distinguish sublicense rights from “have made” rights. A third party sublicensee typically receives the same license rights as the licensee, while a third party manufacturer is only permitted to manufacture licensed products for the licensee in accordance with the terms of the license agreement. The “have made” manufacturer cannot sell the licensed products to anyone else, and the licensee remains responsible for the actions of the manufacturer.

An important issue that arises when sublicense rights are granted is whether the sublicensee’s license rights will continue after termination of the licensee’s rights under the license agreement. Ordinarily, termination of license rights results in termination of sublicense rights, but exceptions exist.

3.5 Consideration

In exchange for the license grant, the licensee must provide consideration to the licensor. This consideration may be monetary or involve the transfer of something else of value. Monetary consideration generally falls into two broad categories: fixed payments or running royalties, alone or in combination. Fixed payment schemes include full payment upfront, i.e., at the time the license agreement is signed, fixed payments paid over specified time intervals, and fixed payments made upon the occurrence of certain events, i.e., achievement of certain milestones. Running royalties are typically a percentage of Net Sales, as discussed above. They may also be structured as a fixed fee per unit, a percentage of the licensee’s cost savings, a percentage of the licensee’s profit margin, a percentage of the licensee’s cost of goods sold, or in other ways.

While certain broad ranges of royalties exist in given industries, there are so many variables that affect royalty rate that it is difficult to develop any meaningful generalizations as to what is a standard royalty in a given industry. However, as a starting point there are publications and websites that provide survey results concerning royalties in various industries.

Most typically running royalty payments are paid on a quarterly basis. However, other payment intervals are sometimes used. Payments for a given quarter are generally due 30-60 days after the close of the quarter.

3.6 Audits and reports

In the case of running royalties, or other situations where the consideration due the licensor is dependant upon actions of the licensee that are not of public record, it is essential that the licensor has the right to audit the records of the licensee. The audit process involves a review of the licensee’s sales and other records to confirm all royalties and fees earned have been paid. Issues to consider in drafting audit provisions include when and where the audit may be conducted, the amount of advance notice required, who can conduct the audit (e.g., licensee’s personnel or an independent CPA), whether interest is due for detected underpayment, whether the licensee pays for the audit if underpayment exceeds a specified amount (5-10% is typical), audit time periods, record retention periods, and whether copies of the licensee’s records may be removed by the licensor’s auditors. Confidentiality of the licensor’s records and the identity of its customers is also an issue of concern.

To facilitate the licensor's assessment of whether sufficient consideration has been paid, license agreements normally require that a report be provided in connection with payment of royalties or other fees that are dependant upon activities of the licensee. License agreements typically specify that the report include one or more of the following: a description of products on which royalties or other payments are being made, the royalty rate, when more than one rate is specified, the deduction from gross sales to reach Net Sales, and total payments made.

3.7 Confidentiality

License agreements frequently include confidentiality provisions obligating one or both parties to keep confidential information provided by the other party. The nature of the confidentiality provisions and the type of the information to which the obligation applies will vary greatly depending upon the context of the agreement, the subject matter licensed, the parties sensitivity to confidentiality, and other matters. At the least restrictive end of the spectrum, the confidentiality obligation may only extend to the terms of the license agreement. Where confidentiality is essential to the agreement, e.g., in the case of trade secret licensing, detailed and aggressive confidentiality provisions are often used.

There are a number of issues to address in structuring confidentiality provisions. The term of confidentiality, i.e., a period of years or perpetual, and how the term is measured, i.e., from date of disclosure or for a number of years after a specified date, is often specified. Consideration should be given to whether or not a restriction on use of the information, in addition to a restriction on disclosure, is appropriate.

From the perspective of the party receiving confidential information it is generally desirable to specify the standard of care that needs to be exercised to prevent unauthorized use and disclosure of the confidential information. Recipients of confidential information should avoid agreeing to an absolute duty of non-disclosure and restricted use. Instead, the discloser should be satisfied by the recipient's commitment to adhere to the same standard of care as the recipient uses with its own confidential information. Disclosers of confidential information should consider qualifying this standard with the obligation that the recipient, in any event, use at least a reasonable standard of care to prevent unauthorized use or disclosure.

To assist the recipient in complying with its confidentiality obligations it is generally preferable to require the discloser to clearly label its confidential information as such, and indicate at the time of disclosure of information not so labeled, whether orally, visually or in hard or soft copy, that the information is confidential. It is also common to require the discloser to follow up with a written summary of the confidential information so disclosed without confidentiality legend.

Need to know restrictions are also often included in confidentiality provisions. These restrictions identify the group of individuals to whom the discloser's confidential information may be provided, e.g., employees and consultants. A related provision is often included obligating the recipient to obtain an agreement from such individuals that they will treat the recipient's confidential information in accordance with the confidentiality provisions of the license agreement. Exceptions to what is defined as confidential information are also common, e.g., information that enters the public domain through no fault of the recipient. In cases of trade secret licensing, other restrictions on disclosure and use are often appropriate.

3.8 Term/termination/consequences of termination

The majority of license agreements exist for a specified term of years, although agreements with perpetual terms certainly exist, particularly in the case of trade secret licensing. In the first instance, it is important to address this issue. Often agreements that should extend for only a term of years will extend in perpetuity as a consequence of failure to address this issue.

The term may be defined as a specified number of years, may extend through the occurrence of a specified event, e.g., expiration of a patent or payment of minimum royalties, or may otherwise be characterized. The nature of the intellectual property involved, the business context in which the license agreement exists, the respective leverage of the parties and other factors will influence the term of the agreement.

Various events may give rise to termination of the agreements, which events should be specifically recited, at least from the perspective of the party most affected by the event. Expiration of the specified term is always one such

event, although such occurrence is sometimes referred to as expiration rather than termination. Failure to comply with a material obligation is another event. In some cases a party may require the option to terminate without cause, i.e., termination for convenience. In cases where a licensor is offering a non-infringement warranty, the licensor may want to reserve the right to terminate in the event such infringement cannot be resolved under specified circumstances. Bankruptcy and other business failure events are also frequently included as grounds for termination. Other termination events will also be specified in certain instances.

Depending upon the perspective of the party involved, it may be desirable to specifically call out what happens in the event of termination. For instance, in the event of termination by the licensor due to failure of the licensee to make payments due, the licensor may want the licensee to immediately cease sale of the licensed products. The licensee, on the other hand, may want a reasonable wind-down period with respect to existing inventory.

The issue of license agreement term, events giving rise to termination and the consequences of termination should be considered together, as there is a close relationship between these provisions. There is a tendency to avoid careful consideration of these terms at the time the license agreement is being negotiated because the parties are typically optimistic that only good can come for the licensing relationship. However, addressing these issues at the outset will aid both parties should disputes arise, and can reduce issues that need to be litigated in the event of a serious dispute.

3.9 Warranties and warranty disclaimer

Two of the most contentious issues in the negotiation of license agreements are the warranties and warranty disclaimers. Each party generally wants to offer no warranties and specifically disclaim any warranties, and yet demands that the other party offer broad warranties without disclaimer. However, certain norms do exist. It is common for the licensor to warrant that it owns or has the right to license the intellectual property that is licensed, has the corporate and other internal authority to grant the licenses, and the licenses granted to not conflict with other agreements to which the licensor is a party. There are a myriad of other warranties that may be included in a license agreement, the selection of which will depend upon the intellectual property licensed, the leverage of the parties, consideration paid, and a host of other factors.

Warranty disclaimers are used to limit the scope of warranties provided to what is expressly provided. To be legally binding, certain warranties must be prominently disclaimed, hence the inclusion of disclaimer provisions in all upper case letters.

3.10 Indemnification

It is common in license agreements for one party to indemnify the other party in the event certain specified events occur, e.g., infringement or products liability claims. Indemnification may include the obligation to defend the other party, but almost always includes the obligation to hold the other party harmless against specified events, e.g., by paying a damage award against the indemnified party. The specific language of the indemnification provisions is also another area that is often hotly negotiated.

3.11 Limitation of liability

Parties to a license agreement often seek to limit their liability arising from their bad acts under the agreement. Such limitation may be directed to incidental and consequential damages arising from their bad acts, thereby limiting their exposure to only direct damages. The latter are damages that flow directly from the bad acts, while incidental and consequential damages are damages that are one step removed from the harm immediately arising from the bad act. For example, if a licensor suffers a loss of revenue because it cannot introduce a product in time for the holiday sales season due to insufficient capital to purchase the materials required to manufacture the product, and this capital deficiency arises from the licensee's failure to make a royalty payment on time, this would be considered a consequential damage. On the other hand, loss of the royalty payment would be considered direct damage.

In some cases license agreements also include an overall monetary cap on liability for one or both parties. Such limitation on liability specifies that no matter what the bad act, the bad actor's liability will not exceed a specified amount. These provisions are not always enforceable due to equities of the situation, laws prohibiting such provisions and for other reasons.

3.12 Infringement

License agreements often address what happens in the event third parties infringe the intellectual property licensed under the agreement. It is also common to address what happens if the licensee's exercise of its license rights results in infringement of third party intellectual property.

3.12.1. Infringement of licensed intellectual property by third parties

Nonexclusive licensees are rarely given any rights, and are rarely the recipient of any licensor obligations, relative to infringement of licensed intellectual property by third parties. This issue is often addressed, however, in the context of exclusive license agreements. There are a variety of ways this is handled. In some agreements the exclusive licensee is given the right to initiate litigation to halt infringement, with the licensor agreeing to join the litigation as a nominal plaintiff if required. In other agreements, the licensor is given the first right to initiate litigation, with the licensee receiving the right to litigate if the licensor does not take action within a specified period of time. In yet other cases, the licensor reserves the sole right to conduct litigation.

Other issues are also typically addressed in infringement provisions. The issue of who bears the expense of litigation and how any damage awards will be divided is often addressed. The obligation of the party not initiating the litigation to assist the party initiating the litigation is frequently covered. The circumstances under which the party initiating litigation can settle the dispute is also commonly included.

3.12.2. Infringement of third party intellectual property by the licensee

What happens in the event of the licensee's infringement of third party intellectual property relates closely to the warranty discussion provided above, and generally arises in this context. More often than not, this issue is addressed by the licensor specifying that the licensed intellectual property is licensed without warranty of non-infringement. In cases where the licensor accepts a non-infringement warranty, it is important that the licensor's sole and exclusive obligations be specified. These obligations typically include attempting to modify the licensed intellectual property to avoid infringement, seeking a license from the third party whose intellectual property is infringed, or refunding monies paid by the licensee. Ideally, from the perspective of the licensor, its obligations in the event of infringement are limited to these actions, and it has the choice of which option to pursue. The licensee, by contrast, will try to avoid such limitation, and may want to require the licensor to use best efforts to achieve a non-infringing redesign or license.

3.13 Assignment

License agreements often include provisions governing the circumstances under which the agreement may be assigned to a third party. In the absence of such provisions, license agreements are generally assignable in connection with the sale of all the assets and liabilities of the company or, in most cases, that portion of the company to which the agreement relates. State law does vary on this issue, however.

Parties to license agreements should give careful consideration to conditions under which the agreement may be assigned. Where assignment is not desired, this should be specifically recited, and it should be specified that any attempted assignment is null and void and terminates all rights of the licensee.

As a related concept, the parties to a license agreement should consider if they want the agreement to continue in the event of a change of control of one party. For example, if a competitor of the licensor buys a controlling interest in the stock of the licensee should the licensor obtain the right to terminate the agreement?

3.14 Alternative dispute resolution

Disputes arising under the license agreement need not be resolved in the state or federal courts. Instead, the parties may want to specifically agree to alternative dispute resolution. Such a process can be particularly attractive when sensitive confidential information must be produced to resolve the dispute, e.g., trade secret information of continuing value to the licensor. Provisions mandating such practices vary significantly in nature and scope. Such provisions may only require that the parties meet and attempt to resolve their disputes before litigation is commenced. As another option, the parties may want to agree to use a mediator to resolve their dispute. The parties may also elect to use arbitration, either advisory or binding. As yet another approach, the parties may elect to use a mock trial to assess the strength of their respective positions.

Regardless of the approach selected, it is generally advantageous to address in some detail how the alternative dispute resolution will be conducted. The parties should consider issues such as location, mediation and arbitration rules to be used, choice of law to be applied, selection of mediators and arbitrators, payment, consequences of completion of the process, right to injunctive relief and other factors.

4. LICENSING CONSIDERATIONS IN SPECIFIC CONTEXTS

The preceding discussion of licensing relates, for the most part, to all types of intellectual property in all contexts. However, there are a myriad of issues that are specific to the type of intellectual property being licensed, the nature of the parties involved and other factors. In the discussion below, licensing issues specific to patents, trade secrets, trademarks and copyrights are discussed. Also, special licensing considerations that arise when the other party is a university or a foreign company are addressed

4.1 Patents

Patent licensing involves a number of issues that are unique to this field. The importance of addressing these issues in the license agreement will, in some cases, be influenced by whether a party is a licensee or a licensor.

It is frequently advantageous, particularly when the licensor has retained the right to collect damages for infringement, to include provisions obligating the licensee, and any sublicensees, to mark licensed products with the numbers of the patents under which license rights exist. Such marking will permit the patent owner to obtain damages from the date infringement commences (assuming the products are marked as of such date). Without marking, infringement damages are generally only available after the infringer is actually notified of its infringing activities, although exceptions exist, most notably infringement of process patents. Proper notice involves placing the patent number, i.e., “pat. 6,666,666,” or “patent 6,666,666” directly on the product, or on packaging for the product or labels for the product where as a result of the character of the product it is not possible to place the patent number directly on the article.

To maintain a patent for its entire term, 20 years from the filing date in the United States and most countries, it is generally necessary to pay maintenance fees at periodic intervals. Failure to pay such fees on a timely basis will result in automatic expiration or lapse of the patent, thereby rendering it permanently unenforceable. Licensees will often want to add provisions to a license agreement that contractually obligate the licensor to pay maintenance fees on a timely basis. Because the licensor may want the flexibility to stop paying expensive maintenance fees, patent maintenance provisions are often structured such that if the licensor elects not to pay maintenance fees, the licensee has the right to do so. Issues such as advance notice of non-payment, and whether patent ownership is transferred to the licensee as a consequence of its payment of maintenance fees, are often addressed in patent maintenance provisions.

Great flexibility exists in how a patent license grant can be structured. However, certain approaches to licensing are not permitted under the doctrine of patent misuse. A patent is misused by employing it to violate antitrust laws or impermissibly expanding the scope of the patent. Patent misuse, which is an affirmative defense to patent infringement, can occur in several ways. When a licensor requires the licensee to pay royalties after the patent has expired, the licensor is misusing its patent. Obligating a licensee to purchase or license unpatented items as a condition for licensing a patented item can, under certain circumstances, give rise to patent misuse. Under some conditions, package licensing of patents, i.e., requiring a licensor to license a group of patents when the licensor only desires a license relative to a subset of the patents in the group, will constitute patent misuse. Other opportunities for patent misuse also exist.

4.2 Trade Secrets

Special provisions are needed in technology transfer, know-how, and trade secret licensing (these agreements will be referred to below, collectively, as “trade secret” license agreements). As noted above, confidentiality is a particularly important aspect of any trade secret license agreement. Thus, the confidentiality provisions of such agreements are typically longer and address more issues than in agreements where trade secrets are not central to the license grant.

It is generally advisable to include a specific clause regarding the licensor's obligation to provide deliverables, such as drawings, software, and prototypes, to the licensee. As there will often be disagreement as to the content of the deliverables, a specific description is often desirable. Deadlines for delivery of the deliverables, and where and to whom the deliverables are to be provided are also frequently addressed in provisions concerning deliverables.

In many cases, the licensor will be obligated to provide technical support to the licensee with respect to the licensed trade secret. Because the licensor and licensee will often have conflicting desires as to the amount, timing, quality, expense and other aspects of the technical support, it is generally desirable to address these aspects in some detail in the license agreement.

Defining the trade secrets licensed requires care from the perspective of both parties. As briefly noted above, the deliverables and information provided during technical support are typically included in the definition of the licensed trade secrets. Other information that may need to be included in the definition includes information provided before the license agreement is executed, such as under a confidentiality agreement between the parties, and improvements to the deliverables that the licensor develops.

It is important for the licensee to consider if it can practice the licensed trade secrets without infringing patents of the licensor. While it may be possible to assert an implied license is granted under the patents, this is ill advised. The better approach is for the licensee to at least seek a license under those patents of the licensor that will necessarily and unavoidably be infringed as a consequence of practicing the trade secret license grant. Broader patent licenses will frequently be negotiated.

Combined patent and trade secret license agreements, along with other so-called "hybrid" agreements involving patents and other forms of intellectual property, present a special trap for the unwary. Patent misuse can arise when a single royalty stream is provided for both patents and technology, which royalty rate continues unabated after one or more of the patents expire. The basis for such misuse is that royalties cannot be collected on unexpired patents, and by not reducing the royalty rate as patents expire royalties are necessarily being collected on expired patents. This issue is ideally addressed by using separate patent and trade secret license agreements. Another approach is to provide for separate royalty streams for patents and trade secrets, with the patent stream being reduced or eliminated as patents expire. Avoiding the problem of patent misuse is most challenging in situations where patent applications have been or will be filed, but no patents exist at the time the license agreement is signed, and the agreement provides the licensee with rights under any patents of the licensor that must necessarily be practiced to practice the trade secret license grant. However, competent legal counsel should be able to develop approaches for reducing or eliminating the patent misuse exposure under these circumstances.

4.3 Trademarks

Trademark licensing, like other topics discussed in this article, involves issues that are beyond the scope of this article. However, it is important to be aware of some of the most important issues. It is essential that the trademark owner ensure that the quality of the licensed goods and services consistently meet the owner's quality standard. In support of this requirement, trademark license agreements will generally include quality control provisions defining the quality standard that the licensee's goods and services must meet.

Trademark licensors need to be attentive to the manner in which the licensee is using the licensed marks to prevent weakening or loss of the marks from improper use. To aid in achieving this objective, licensors often require licensees to present samples of all proposed trademark use in advance of first use to permit the licensor to object to improper use of the marks. Alternatively, or additionally, license agreements sometimes include detailed guidelines concerning how marks may be used.

There may be a motivation for licensees to register identical or related marks in the United States and foreign countries in their own name. This can create substantial legal problems for the licensor. Thus, from the licensor's perspective, it is desirable to include provisions specifically prohibiting such actions, and obligating the licensee to assign any such marks to the licensor upon request.

4.4 Copyrights

While all forms of intellectual property can be divided up in various ways in connection with licensing, copyrights are perhaps most susceptible to such division. Consequently, any company involved in copyright licensing should be freely creative in devising the language of copyright license grant. Division can occur among the various statutory rights, such as reproduction, derivative works, between media type, e.g., film, book, website, based on usage, e.g., use and execute, and in other ways.

Technology companies most often face copyright licensing issues in the context of software licenses. There are a number of important issues to address in software licensing. One issue is the nature and time period of the performance warranty. When provided, which is not always the case, the performance warranty standards are typically defined as those standards set forth in specifically identified documentation, and the warranty is very short in duration, e.g., 60-90 days. Another issue is the period during which the licensee may accept or reject the software after installation. This period is typically very short, often 15-30 days. Because of the inherently “buggy” nature of software, warranty disclaimers and liability limitations are generally more favorable to the licensor than in intellectual property license agreements involving other types of intellectual property, or copyrights in non-software contexts.

4.5 Foreign licensing considerations

As companies expand, the need will frequently arise to enter into license agreements with companies based in countries other than the United States. There are a number of considerations that must be kept in mind when licensing intellectual property with foreign companies.

The license drafting and negotiation process will proceed more efficiently with an awareness of some of the differences in approach between United States and foreign companies. These differences are most pronounced with smaller foreign companies, but also exist to some degree with large multi-national corporations based outside the United States. While certainly a generalization, there is a tendency for foreign companies to prefer shorter and more straightforward license agreements than are the norm in the United States. Also, foreign companies do not generally address in the same level of detail how various contingencies under the agreement should be addressed. Thus, while a license agreement drafted by a United States company may discuss in detail what happens in the event of breach of the agreement by one of the parties, a comparable agreement drafted by a foreign company may well be silent on this issue. There also appears to be less willingness on the part of foreign companies to volunteer information of relevance to the other party than is the case in the United States. As such, it is important to ask questions freely, particularly relative to the most important aspects of the agreement.

Language differences can also present problems, although this is becoming less of an issue than in years past with the increasing dominance of English as the worldwide language of commerce. Nevertheless, where the other party is based in a non-English speaking country, it is usually desirable to specify the official language of the license agreement. This language should be the same as the language of the country where any disputes are to be resolved. Also, it is generally preferable to err on the side of including more definitions in a license agreement with a foreign company than might be included in a comparable agreement with a United States company.

Licensing strategy with foreign companies is often influenced significantly by differences in law between the United States and the foreign country. For example, because the European Union lags the United States in its willingness to grant patents directed to methods of doing business, it may be desirable to structure a licensing relationship with a foreign company such that the company is obligated to make and sell products in the United States. Not only are there differences in intellectual property laws between the United States and foreign countries that need to be considered, but differences in the related fields of anti-trust, employment and tax are often germane. Because of differences in laws it is often essential that one or more foreign lawyers be consulted by a United States company in connection with licensing of intellectual property to or from foreign companies. Also, it is important to allow sufficient time to obtain governmental approvals that may be needed to consummate the license agreement.

Another legal issue to bear in mind when dealing with foreign companies is the export control laws of the United States. Providing technical information to a foreign company absent a license from the United States Government will, in some cases, result in violation of export control laws, with potential serious legal consequences. Even

providing a patent application to a foreign patent office absent a license may constitute a violation of the export control laws.

4.6 Licensing considerations with universities

With the passage of the Bayh-Dole Act in the mid-1980's, universities have embraced patent licensing as an important institutional objective. Certain differences, however, exist in the way license agreements with universities are structured relative to comparable agreements with companies.

In spite of the appeal of patent licensing, a university's central mission remains seeking knowledge and providing it publicly to others. This mission can conflict with the ability to protect inventions by patent, particularly foreign patents. In this regard, optimal patent protection is obtained, from a worldwide perspective, only if a patent application is filed before an article divulging the invention is published. To balance the competing interests of disseminating knowledge as quickly as possible with protecting inventions by patent, agreements with universities involving the development of inventions generally grant the licensee only a limited period of time to review inventions developed by the university. During this period the licensee must assess if it wants to file a patent application, or require the university to file, depending upon the agreement, and actually complete preparation and filing of the application.

The Bayh-Dole Act also imposes obligations on universities that result in the inclusion of certain provisions in the license agreement. Universities are obligated to seek manufacturing of the licensed products in the United States to the extent possible. As a result, it is typical to find provisions to this effect in patent license agreements with universities. Also, the Bayh-Dole Act encourages universities to actively commercialize inventions to "stimulate the economy and promote the public good." As a result, it is very common to see provisions conditioning the license grant on achievement of specified milestones.

While many universities actively license patents, they do so in a way that will not compromise or expose the assets of the university. Indeed, because of this issue, patents arising from the work of university employees are often held in a separate entity. In any event, universities tend to be more insistent on limitations of liability, warranty disclaimers, monetary caps on liability and other provisions that limit legal exposure than other entities.

5. CONCLUSION

Licensing of intellectual property is an exciting and potentially rewarding undertaking. To maximize the effectiveness of any licensing activities, it is important that the pre-licensing considerations discussed above, particularly those pertaining to ownership, be carefully considered. In view of the complexity of the legal and business issues associated with licensing, it is generally desirable to obtain professional assistance. However, the various issues discussed above provide an overview of important issues that frequently arise in the licensing of intellectual property.