The ABCs of Licensing Intellectual Property

IP Law Bulletin
on 04.01.2010 | Posted in Copyright, Trademarks

Intellectual property rights broadly encompass patents, trade secrets, know-how, proprietary data, registered designs, copyrights and trademarks, among other things. Most often, such rights originate with a commercial entity and the owner retains the rights throughout their lifetimes as legal leverage against competitors.

However, there are times when an owner of intellectual property (IP) may want to transfer some or all of its IP but an outright sale is not an attractive option. For example, the owner may be a non-practicing entity (NPE) – a term that encompasses (1) individual inventors who, for one reason or another, may not be able to commercialize their IP, (2) universities and other research institutions that seek to transfer technology as part of their mission, (3) commercial entities whose business plans change and find themselves with surplus IP or (4) so-called “trolls” that accumulate patents and other IP as middle-men and then seek to license the rights to the highest bidders.

Even when the owner practices the IP, there can be advantages to sharing IP with others, e.g., as part of a settlement of litigation or a cross-license that may resolve a stalemate where two or more parties may have mutually blocking IP.

Licensing, as opposed to complete transfer or assignment of IP, provides the owner with several advantages. By retaining ownership, the seller (licensor) retains title and typically has an easier time reversing the transfer of rights if the buyer (licensee) doesn’t live up to its end of the bargain. In many instances, the party seeking to acquire the IP rights does not have sufficient financial resources to pay the full value upfront – or may perceive the IP as highly speculative but be willing to pay more if the technology can be successfully commercialized. A well-drafted license agreement therefore not only gives the licensor an opportunity to more readily terminate the agreement if future payments are not made but also allows the parties to “share in the upside.” License agreements can also delineate the responsibilities of each party for maintaining or enforcing the patent rights.

Thus, licensing allows greater flexibility and reduces the risk that the IP will be over or undervalued. If the desired revenue strategy is a stream of income, i.e., royalties or contingent payments, then licensing is often the most appropriate choice.

What are the components of a license?

A typical patent license will specify the rights granted, the term of the grant, the consideration in exchange for the grant, records and reporting, representations and warranties regarding the patent, how infringement issues will be handled, tort liability for products or services covered by the license, and other factors.

Grant clause
The grant clause sets forth what patent rights are being conveyed. The grant can be exclusive (i.e., only the licensee has the right to exploit the patent rights) or non-exclusive (i.e., the licensor can grant similar rights to other parties). The grant can be limited by geography (such as U.S., worldwide), and field of use (such as for cellphones but not laptops).

**Improvements**

A patent license can also define each party’s rights to improvements of the patented technology. Depending on the negotiation, improvements might be solely owned by the licensor, licensee, or jointly owned by both. The party with more bargaining power often insists on controlling the rights to improvements.

**Consideration**

The payment of consideration can be structured in many ways. The license agreement typically requires a licensee to pay an upfront license fee as well as ongoing royalties based on a percentage of sales or on a per-unit basis. The license can also require minimum annual royalties or minimum annual product sales to be sure the licensee is diligently marketing the products or services covered in the patent. The license agreement can also require that the licensee provide reports to the licensor, e.g., of sales or revenue, to ensure accurate royalty payments.

Milestone payments are a particularly useful way to deal with the speculative nature of IP rights and ensure that the licensor shares in the success of commercialization. For example, milestone payments upon capitalization of the licensee or FDA approval of a product that embodies the IP are common provisions.

Shifting the financial responsibility for the ongoing pursuit of patent rights or maintenance of such rights is another form of consideration that a licensor may seek as part of the agreement.

**Infringement**

A patent license can also control each party’s responsibilities for enforcing the patent rights along with apportioning liability if the licensee is sued for infringement. Generally, each party wants to have control of any infringement litigation but also wants to avoid being required to defend or indemnify the other party.

Depending on the terms of the agreement, an exclusive licensee can have the right to sue for infringement. The license agreement can determine how the costs of litigation are apportioned between licensor and licensee. For example, the license can provide a licensee the right to withhold all or part of royalties to offset costs of litigation. The license agreement can also define how the proceeds of successful litigation are divided. Damages can first be allocated to cover litigation costs and then divided between the parties according to predetermined percentages, for example.

**Due diligence**
License agreements can require due diligence by the licensee to develop and/or commercialize the IP. Such terms are typical in university license agreements to ensure that the IP is used and not just put on the shelf. For example, the licensee can be required to use reasonable efforts to develop and commercialize products covered by the license. License agreements will also typically include milestones that must be met in order for the licensee to maintain the license. The license can also require submission of periodic reports regarding the licensee’s activities related to the development and testing of the products covered by the licensed IP.

Indemnities and product liability

Licensors and licensees can provide various indemnifications to each other in a license agreement. The license can include representations and warranties concerning the IP and can require indemnification against any inaccuracy or loss arising from those representations and warranties. For example, the license can include representations by the licensor that they own clear title to the IP, that the IP is valid and enforceable, and/or that none of the products produced under the IP are known to infringe other IP held by third parties. In turn, the licensor can require the licensee’s compliance with applicable laws, such as export controls, tax codes, etc.

The license agreement can also include indemnification terms ensuring that liability for defective products produced by the licensee does not extend to the licensor, who likely has limited if any control over the actions of the licensee. Alternatively or in addition, the licensor can require that the licensee carry sufficient liability insurance.

Dispute resolution

License agreements can require the parties to provide notice of any breach of the agreement and can specify periods during which any such breach can be cured. The license agreement can also be drafted so as to provide in advance for arbitration or mediation of disputes. For example, the agreement can require binding arbitration rather than litigation.

Transferability

License agreements can provide the licensee a right to sublicense or assign the IP. The licensor can require approval of any such sublicense or assignment. For example, the licensor may wish to prevent a competitor from obtaining license to the IP. However, it can be important for the licensee to have the ability to assign the license without restriction as part of the transfer of the business.

Termination

License agreements can include negotiated provisions that establish how and for what reasons the agreement can be terminated. For example, the agreement can specifically provide for termination upon breach of certain terms of the agreement. Note, however, that clauses that provide for automatic termination of the license agreement if one or the other party seeks or is placed under bankruptcy protection may not be enforceable. On the other hand, clauses that provide for termination for failure to pay royalties may be enforceable regardless of bankruptcy.
This advisory was prepared by Nutter's Intellectual Property practice. For more information, please contact your Nutter attorney at 617-439-2000.

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