

## The Licensing of Intellectual Property Rights

The approach to generating a license varies from a licensor/owner of technology looking for a partner who will use it to a licensee/user looking for a new or improved product. A variation on this perspective occurs when infringement litigation is settled through the grant or exchange of a license.

Licensing is an important tool in the world of technology. Rising costs of research and development pose additional pressures on enterprises to find resources or gain a return on their investment. Licensing provides additional revenue for a business or university's useful or promising technology. Similarly, for those businesses needing an immediate infusion of technology to enter or expand a market, the license provides a ready source.



### Basis for the License

Whether a right is granted in the form of a patent, trademark, or trade secret, the right becomes the center of interest of the negotiation and the measure of the bargain that is reached. These license rights are the equivalent of goods or services that the licensee seeks and pays for. In this segment of the world of commerce, this is another illustration of the struggle of supply and demand.

The traditional "goods" that are licensed are the patent and the trademark and frequently include the sharing of technology. The rights to these goods—

commonly referred to as intellectual property—are distinguished by having gone through a governmental review and the issuance of a certificate of registration. Thus, there is an "official" confirmation of a res—that is, a property that can be possessed, traded, or coveted as chattel or goods. In the instance of the patent, the registration document includes a precise description of the invention, some insight into its manufacture and use, and the equivalent of an official "survey" of its boundary, as defined by the issued claims. The trademark provides a similar certificate that informs the public of the mark and identifies

the sphere of influence through the description of goods or services to which the trademark use applies.

While the patent and trademark are the most common bases of licenses, technology and product registrations of different varieties may also be licensed. Technology (that is, know-how or trade secrets) is frequently licensed in conjunction with a patent and maybe with a trademark. Alternatively, there may not be a patent but a valuable package of information about relevant research and development, a manufacturing process, or a file of data on product performance—none of which is freely available to others and each of which may form the basis of a license.

### Scope of the License

A licensor grant of the license right is either exclusive or nonexclusive. A nonexclusive grant implies that there are, or may be, other grantees of the right. Significant to the exclusive licensee is whether the grant of license precludes the licensor of a continued right to use the rights that have been licensed. The U.S. presumption is that the exclusivity precludes future use of the licensed right by the licensor. Certainly, if the licensor intends to also practice the rights licensed, the license should clearly provide for this use.

The grant of a patent license typically spells out the particular rights to be enjoyed—such as the right to make, have made, use, and sell products incorporating the patented invention—but all of these particular rights are not necessarily granted. The conventional language of the grant stems from the statutory definition of the rights of exclusion inherent in the issued patents. In the instances of other license rights such as a trademark or a file of technical information, the grant typically is to use the mark or information.

An additional right that may be conferred in the license is the right to sublicense the licensed rights (patent, trademark, technology, etc.). The conveyed right of sublicense permits the licensee to grant the rights to others. This may be done consistent with the extent of the original license grant (or its scope, such as technical field or commercial market, may be restricted) or with the addition of the licensee's own rights (additional patents or technology that has been accumulated by the licensee). Should the licensee have the right to grant a sublicense, the original license grant usually specifies to what degree the original licensor shares in the income from the subsequent licenses. Counsel for either a licensor or li-



censee should carefully identify and define the client's interests—including policing of the subsequent agreements and liability for collection of sublicense royalties.

### Consideration

Because the opportunity to use patents or technology is the prime mover causing the licensee to enter into an agreement with the licensor, the fees and prospective royalties paid or exchanged for the technology received are the features that entice the licensor into the agreement. Fees and royalties may be paid over a variety of different schemes, including periodic fixed payments, minimum payments, variable royalty rate schedules, and time limits on payments. Frequently, the consideration includes a cross-license on different licensable properties of the licensee or the grant back of new technology or patent rights that have their inception in the right that was originally licensed.

The money paid for the licensed right may be a sum certain or a running royalty triggered by sales or use of the right—for example, by manufacture or sale of the product. In the instance of the sum certain, the amount may be paid as a lump sum, which is traditionally paid when the license agreement is signed, or over a period of time (monthly, quarterly, or annually, for example). The license document may provide that the license is “fully paid up” upon the conclusion of a period of time or the reaching of a preset dollar amount.

Royalty payments are customarily based on sales dollars or units of products embodying the licensed technology or promoted by using the trademark. Amounts due may be calculated as a specific percentage of sales turnover (such as 3 percent of gross sales or 5 percent of “net” sales) that has been accumulated and is to be paid incrementally (quarterly, for example) in a specified currency (normally that of the licensor's nationality). Caution should be exercised when drafting the terms of international payment, because local country exchange controls may restrict the flow of currency or impose an obligation for the collection of taxes. The license document should provide for liability for taxes and bank transfer fees. Similarly, the license drafters should also take into account inflation, currency devaluation, or other economic events.

A cross-license provides access for the licensor of technology and/or patent rights of the licensee with specified consideration for the use of each licensed right. The agreement thus provides for multiple licenses within the one document. Such practice is more common in the settlement of patent infringement or trade secret litigation between competitors, where strong commercial activity in closely allied fields provokes a multifaceted solution to the litigation. In such situations, the license rights granted in one direction might be royalty bearing; in the other

direction, they may be royalty-free or fully paid up.

One consideration of a licensor may be that the technology at issue does not become outdated. Accordingly, the license may provide that the technology developed by the licensee, stimulated by the licensed right, be documented, and that a license for that subsequent technology flow back to the original licensor. This “grant-back” provision is usually nonexclusive and may be royalty-free. In licensing among competitors in a given market, terms that are overly friendly or more favorable than an arm's length business situation requires may provoke charges of anticompetitive activity raised by competitors who have been excluded or supervising governmental agencies. Conversely, a licensee may want the benefit of continuing development of technology by the licensor. In such instances, licenses frequently provide for the inclusion of such future developed technology to be included in the license, with the net result being an extension of the term of the license and the obligation to pay royalties.

### Definitions of Terminology

Within the license agreement there are certain defined terms that describe or limit the licensed rights. More than any other aspect of the relationship between the parties, clarity and universal understanding of the terminology used in the license agreement will promote continued respect and cooperation among them. The following list explains some of the fundamental terms of the license that need special care when the agreement is drafted:

- **Field of Use:** License rights are frequently granted for limited application. An owner of an extensive portfolio of patents and technology who is using them to advance the manufacture and sale of certain products for his or her own business is likely to restrict a licensee from use of the rights in similar fields. The thoughtful licensor carefully drafts the definition of the field of commercial application within which the licensee may practice the license rights. Inartful drafting may expose the licensor to either competitive or legal difficulties.
- **Product:** Frequently, the licensed right will be either confined to a particular product or restricted from use by a particular product. Such limitations are frequently reached in licenses that stem from resolution of infringement in patent or trademark enforcement. Similar guidelines and cautions as those described in defining field of use should be used in product definitions, because the parties are frequently competitors. Product definitions also may have an impact on the calculation of royalties, timing of events, or other contract obligations.
- **Duration:** The license term sets the length of time

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that the licensee enjoys the licensed right. What is not so obvious is what right or obligation, if any, the parties have when the term expires. Existing law may help in the situation where patents or trademark registrations have not expired. Without a provision within the license document, it is not clear who has the right to practice technology developed years earlier when the license was granted and the technology is now common knowledge and has been significantly advanced by others than the licensor. A well-drafted document also prescribes the wind-up activity and the life after the right expires, including the right to sell off inventory, the return or destruction of technical documents, and follow-up reporting.

- **Licensed Rights/Technology:** Perhaps it is redundant to recommend that caution be taken that the licensed properties including patents and trademarks are completely listed. Care should be taken to include any successive properties to be included later in the detailed list and to explain how they will be added (that is, by event, mutual agreement, or operation of law). It is common for a family of individual patents to issue successively from an initial application. The document should state the extent to which these additional properties are included in the license rights. Similarly, in the case of trademarks, there may be variations on the theme or style of the original mark; therefore, the document should define successive rights to these variations. When the licensed rights are to a package of technology, the licensor's right to further developments should be addressed. In all instances, the drafter of the document should consider the requirement of additional consideration for the use of successive rights (in addition to that already prescribed for a "use").
- **Territory:** As important as defining the field and term of the license is the definition of the territory in which the rights may be practiced, and presumably whether paying a fee for use is additionally required. Patents and trademarks are national in scope. The identification of a property right that is recognized by another nation, and the licensing of that right, enables the licensor to expand the territory of the license and increase the royalties that will be paid.
- **Net Sales:** Royalties are frequently based on the sales of the products that incorporate or are made with the patented inventions or the licensed technology. It is common for an invoice to exclude from the calculations of royalties certain costs or expenses that bear little relation to the license. The contract term that identifies the accumulated sales activity number on which royalty calculations are made is usually called the "net sales" of the licensed products. The license contract should

include a definition of this term to ensure acknowledgment of all inclusions and exclusions to the royalty base in the calculations of royalties to be paid.

#### **Technology Exchange and Assistance**

The supply of technology by the licensor at the time the license is granted and the offer of continuing assistance may be an important consideration. If the parties bargain for continuing technical assistance that is collateral to the initial exchange, they must set up a mechanism for giving and receiving such information. Generally, the responsibility for adequate provision of these needs lies with the licensee, and failure to provide for these needs at the time of negotiation may leave the licensee at the mercy of the licensor when it comes to continued enjoyment of the fruits of the agreement.

#### **Confidential Information**

The document representing the license for technology also serves to establish the scope of legal protection for that information. If unpatented technology is not maintained in confidence, it may lose significant value. The licensor's opportunity for continued exploitation of the technology rests with the continued confidentiality of the information. Thus, it is the licensor's responsibility to ensure that a licensee is obligated to exercise special care to maintain the confidentiality of the licensed information throughout its use. The licensor may desire to delineate the specific steps that are expected of the licensee while he or she is in possession of the information and is using it and to provide specific penalties for unauthorized disclosure.

#### **Infringement**

After agreeing to pay for the right to use patents or trademarks, the licensee should be concerned with maintaining the value of the bargain. As the licensee commercializes the rights, he or she may discover that either or both of two different infringements are occurring. Of immediate impact on the licensee's ability to continue to do business is the charge of infringement of third-party patent or trademark rights as the licensee markets the products using the license rights. It is incumbent on the licensee to seek provisions in the license that require the licensor's help in defending and abating the infringement of patents and trademarks of others. Agreement provisions requiring the licensor to bear the costs of defense or abatement or share them on some apportioned basis are common. Similarly, another common provision is the requirement to reduce the prescribed royalty rate on some pro rata basis if the licensee has to pay royalties to a third party. The licensee rarely receives a warranty of use of the

licensed right, because licensors are reluctant to “guarantee” absolutely the impossibility of infringement of a third-party patent.

The second type of infringement that is troubling to the licensee is that of a third party’s unauthorized use of the licensed rights themselves. Because the licensee is paying a fee to use a patent or trademark, a third party’s unauthorized use of the rights dilutes the licensee’s bargain. A requirement that the licensor enforce the patent or trademark and terminate the unauthorized use of the licensed rights is a common provision in a license agreement. It is also common to provide that the obligation is to be borne solely by the licensor or with some aid of the licensee. Enforcement of licensed patents generates its own licensee problem. Short of carrying the litigation to a final court injunctive result, the only ways out of the infringement are total capitulation by the third party (which is not likely) and some negotiated right to continue the infringement (that is, another license). Given these circumstances, the original licensee may be placed in a compromised position. If the original license that was granted provided that the licensee had the exclusive right to the patent or trademark, the license suddenly—and without the licensee’s consent or participation—becomes nonexclusive. Even more disturbing, a fierce competitor over whom the licensee may have sought to gain commercial advantage through the benefits of the license may now be a “co-licensee.” The licensee is strongly urged to anticipate the possibility of these scenarios and ensure that the license agreement provides adequate relief.

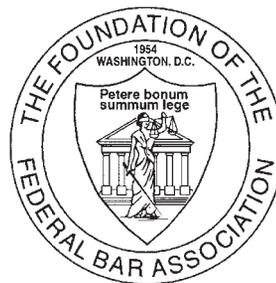
### Inspection

Implicit in any trademark license is a conveyance to the licensee of the right to invite the licensee’s customer to rely on whatever good will has been developed in the marketplace and attributed to the trademark. A requisite to the continued viability of the mark is the licensor’s preservation of the quality of the licensed product so that a customer may continue to rely on the mark as an indication of the reputation imputed to the goods bearing the mark. Thus, in the instance of the trademark license, whether it is for safety sensitive products or not, the licensor must provide for meeting and verifying compliance with product specifications in order to ensure a level of quality that is similar to the licensor’s.

### Product Liability

The structure of the legal system in the United States gives citizens easy access to the courts to redress perceived wrongs and injury. The prudent license drafter will clearly establish the respective liabilities of the parties for several actions. If the product design, including specifications, is imposed by

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## Memorials and Remembrances *Gift Program*

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rendition of his service or to the protection of rights or property of the provider of that service.”

<sup>28</sup>*Id.*

<sup>29</sup>*Id.*; Hornung, *supra* note 4, at 138.

<sup>30</sup>18 U.S.C. § 2511(2)(d).

<sup>31</sup>DiLuzio, *supra* note 2, at 748; *see also Campiti v. Walonis*, 611 F.2d 387 (1st Cir. 1979).

<sup>32</sup>*Deals*, 980 F.2d at 1157.

<sup>33</sup>*Watkins*, 704 F.2d at 580; but *see United States v. Rittweger*, 258 F. Supp. 2d 345, 354–55 (S.D.N.Y. 2003) (finding consent when the plaintiff knew that the lines

were continuously taped, that the employer reserved the right to listen to those tapes, and the employee handbooks made employer monitoring clear).

<sup>34</sup>*Id.*; *see McIntosh*, *supra* note 19, at 556–557 (citing *Roberts v. Americable Internat'l Inc.*, 883 F. Supp. 499, 502 (E.D. Cal. 1995)).

<sup>35</sup>*McIntosh*, *supra* note 19, at 577.

<sup>36</sup>*See Steve Jackson Games v. United States Secret Service*, 36 F.3d 457 (5th Cir. 1994).

<sup>37</sup>302 F.3d 868, 878–879 (9th Cir. 2002).

<sup>38</sup>418 F.3d 67, 79–81 (1st Cir. 2005).

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the licensor upon the licensee, it is likely that the licensor will be burdened with the defense and indemnity for design defects—both alleged and actual defects. Defects interjected by negligence in manufacturing (including lack of quality control and defective or improper materials) are typically made the responsibility of the manufacturing licensee. Breaches of implied or express warranties are generally founded on product labeling, and these may revert to the product approval process or a licensee’s promotional program; therefore, liability between the licensor and licensee will rest as it was negotiated by the parties to the agreement.

In the United States, insurance covering losses associated with such injuries may be costly or difficult to obtain. If one of the licensing parties does not have liability insurance to cover the licensed property, the indemnity provisions of the license agreement may become meaningless in the event that this party also does not have the financial resource to bear the costs of litigation and indemnity. In such a case, it may be incumbent on the other party to prescribe some additional security to protect its investment.

### Conclusion

The licensing process is a business tool used to commercialize intellectual property. As long as the property can be quantified—either in a registered document such as a patent, trademark, or set of specifications or sequential steps in a manufacturing process—it is capable of being sold, leased, or traded. The approach to licensing begins with the recognition and evaluation of the respective needs of the parties in reaching agreement. The task concludes with the adoption of assurances, guarantees, and alternative obligations in the event the commercial situation should change or go awry. In the middle remains the continuing interest of the licensor and licensee to maintain the value of the licensed property in order to continue (or expand) the commercial return on the investment. TFL

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