MODULE

07

Technology Licensing in a Strategic Partnership

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INTRODUCTION

Companies are always under pressure to keep improving their products; otherwise, they run the risk of losing out to competitors. A company has to keep investing in and making efforts to develop new and better products. However, it is quite possible that someone else has already developed the new or improved technology that it needs.

Without putting in all that effort to develop that same technology, why not use the technology developed by someone else, if that were possible? The context of this module is "Technology Licensing in a Strategic Partnership. "

LEARNING OBJECTIVES

1. You understand the basic of licensing.

2. You learn about the importance of preparing and negotiating a license agreement.

3. You understand the basics of a license agreement.

4. You learn to manage a licensing relationship as well as termination and post termination issues.

LEARNING POINT 1: The basic concept of license

A technology protected by intellectual property (IP) right(s) may be commercially exploited either by the owner directly for making a new or improved product, by transferring it by sale or gift or by licensing it to another.

1. What is a license?

(1) Definition of a license

To license is where an owner of an IP right (licensor) simply gives another (licensee) permission to use that right, while the owner continues to retain the ownership of that right.

(2) License agreement

The permission is usually granted through a written contract where the purpose, territory and the period of time is defined and agreed to by the parties. This written contract is called a “license agreement.”

(3) Types of license

a. Licensing-in

An enterprise obtains technology from an external source. One may license-in as when an enterprise obtains technology from an external source, such as a university, a research laboratory, another company or an individual.

b. Licensing-out

An enterprise transfers its technology to another for the manufacturing of products, for the further development of the technology or to expand its current operations.

c. Cross-licensing

A cross-licensing occurs when two parties licenses their technologies to each other.

More References 1-1: The distinction between a license and an assignment
1. In a license agreement, a licensor continues to own the IP rights but only gives the licensee the permission to use a defined right over one or more IP rights. 2. In an assignment (sale) the ownership of the rights in the IP is transferred from the assignor (seller) to the assignee (buyer). This is a one-time transaction for an agreed price. 3. The distinction between a license and an assignment is also important for determining who has the rights to sue for infringement of a licensed patent and for taxation. (1) Infringement: Who can sue for infringement? As a general rule, only an assignee of a patent can sue for infringement and not a patent licensee. But, in many cases, an exclusive licensee is given the right to sue. (2) Taxation a. License A. Licensee: Royalties paid under a license are deductible business expenses of the licensee. B. Licensor: Royalties paid under a license comprise ordinary income for the licensor. b. Assignment - Assignee: Payments made for an assignment are capitalized by the assignee. - Assignor: Payments received for an assignment may be taxed as capital gains to the assignor.

2. Why license?

A business would consider licensing under these situations:

(1) Essential component of certain business relationships

Many business relationships involve or crucially depend on licensing of IP rights such as when it hires a consultant or collaborates with one or more enterprises which may be vendors or subcontractors for manufacturing a part or component, or when it collaborates on research & development or when it forms a strategic alliance or a joint venture.

(2) Non-core IP for adding a revenue stream

A business may consider allowing another to exploit its IP rights (license) for a fee where it does not or no longer uses a particular IP right in its core business.

(3) Core IP for adding a revenue stream

Even when an IP right is integral to the core business of an enterprise, the enterprise may choose to concentrate on one geographic market (e.g., Germany or Russia) or one field of use (e.g., the market for two-stroke engines) and license to others with greater capacity or interest in other markets or fields of use.

(4) Core business is licensing

Some companies enter into business with the sole objective of creating and licensing IP rights, without ever manufacturing a product; for them the IP is the product.

(5) Forcing an infringer to become a licensee (stick license)

In a situation where the IP rights are being infringed, the owner of those rights may choose to litigate, which could be expensive, with an uncertain outcome and be protracted. A more realistic option may be to put pressure on such infringers to take a license, for example, by threatening to litigate.

(6) Licensing to each other (cross licensing)

In closely-related industries where rivals employ very similar technologies they often infringe upon each other's IP rights. In such situations cross-licensing is relied upon to avoid expensive tit-for-tat litigation.

(7) Patent pools

Where manufacturers don't themselves hold any patents relevant to the products they manufacture and they are held by several patent holders they may license the patents in a group. That is, the patents are put in a patent pool by the patent holders and they are licensed in a package directly by the owners or by an entity established for that purpose. Such arrangements are particularly relevant in the context of *patent thickets* where a single product may involve a maze of patents making its manufacture impossible without dealing with an array of patent holders.

(8) Complying with standards

Sometimes, it is necessary to obtain licenses for protected technologies, which are essential for meeting the requirements of a *de facto* industry standard, or a *de jure* national or international technical standard that has been set by a standard-setting organization. When a license is needed for meeting the requirements of an industry standard, it is generally available on either a royalty-free basis or is negotiated on the basis of what are called fair, reasonable and non-discriminatory (RAND or FRAND) terms.

LEARNING POINT 2: Preparing to license

1. Due diligence

Due diligence is a necessary first step before entering into any kind of business transaction and is particularly important when considering a long-term business relationship, such as an IP license agreement. It must be done both by the licensor as well as the licensee.

(1) The basic concept of due diligence

a. Due diligence is a term used for a number of concepts involving the performance of an investigation of a business or person.

b. Due diligence is a necessary first step before entering into any kind of business transaction and is particularly important when considering a long-term business relationship, such as an IP license agreement. It must be done both by the licensor as well as the licensee.

c. Given the constraints of time and resources, a due diligence exercise should seek to gather and analyze as much information as possible on the potential licensor or licensee, the market, the technology and other similar technologies available in the market or being developed, the legal and business environment (local or international, as required) and any other information that would enable the potential licensor or licensee to be better informed.

d. The purpose of due diligence exercise is to assess potential risks and benefits, identify risks that may undermine the value of technology, and develop strategies for overcoming any such risks. This exercise should naturally be conducted in a legitimate manner, within the bounds of relevant laws.

(2) Information needed for due diligence

In a due diligence exercise, the exact information to be verified would vary, depending on the facts and circumstances of a given situation. However, in relation to patents, the basic information to be sought is as follows:

a. The ownership of the patents; checks whether all the inventors have duly signed an assignment document assigning their rights in the patents to the assignee.

b. The validity and adequacy of the scope of the rights offered; a patent attorney has to analyze the claims of the patents or patent applications being licensed to determine the scope of the claims.

c. Have all proper procedures been followed to ensure effective patent protection in all the relevant markets?

d. The right to use the subject matter; are there any third parties claiming rights over the patents in question.

e. Before licensing patents or patent applications from universities, a potential licensee should carefully consider the impact of government rights in the patented inventions.

f. Can the patented technology perform as per expectations; for example, will it serve to reduce costs, improve performance or deliver other identifiable benefits?

g. What is the economic or strategic value, in that, to what extent do the patents in question fit into and further the business objectives of the two parties to the proposed license agreement?

h. Will other IP rights have to be acquired (for example, a blocking patent of a third party) to fully implement the patented technology in question; is there freedom to operate (FTO) or would one or more licenses to other patents be required too?

i. It is important to develop alternatives to a negotiated deal. Consider strengths of the technology sought to be licensed versus competing technologies available in the market. Most parties, if they are aware that the other party "must" do the deal or the other party has limited alternatives, will seek to extract far more favorable terms.

More References 2-1: The sources of information for licensing
For obtaining information for licensing a range of sources can be usefully consulted. These will include the following: 1. Publicly available information of publicly-traded companies 2. Online and subscription database services for the relevant market or products 3. Trade publications 4. Trade and technology exhibitions, fairs and shows 5. Technology licensing offices of research-based universities and publicly-funded research and development institutions 6. Relevant government ministries, departments and agencies 7. Professional and business magazines, journals and publications concerning the relevant products and markets 8. Professional and business associations 9. Technology exchange 10. Innovation centers 11. Patent information services Depending on the particular field of interest and circumstances, a company will consult one or more of the above sources of information.

2. Valuation of technology

(1) Limitation in valuation of technology

a. Traditionally, the valuation of assets reflected their historical cost, as adjusted by depreciation, and their value was directly related to their expected profitability.

b. In recent years, however, this link is no longer automatically applicable as “new economy” companies generate earning seemingly unrelated to their fixed assets. This is happening, primarily, because of their use of intangible assets.

c. An owner of an asset, a potential purchaser, a financier and an insurer, will each value a fixed asset differently, even though it is an identifiable asset which is measured in a common currency. It thus follows that valuing intangible assets is even more difficult, and even more subjective.

(2) Methods to value technology

a. Cost Approach

   The licensor’s investment in the technology is represented by the costs associated with developing, protecting and commercializing the technology. These expenditures are known to the licensor and can reasonably be estimated by the potential licensee. They represent the base, or minimum that the licensor will want to recover, with interest.

b. Income Approach

   The income approach to valuation involves making educated guesses (or more precise measures, if possible) as to the amount of income that the new technology will generate. The issue then is to determine the respective shares the parties should each have of the benefits and find a royalty formula that matches that calculation.

c. Market Approach

   Sellers and purchasers of real estate and used cars know, or can readily ascertain, what other parties have agreed for similar houses and cars in the same area. It follows that comparable market transactions are a convenient and useful way of determining the value of an asset in anticipation of negotiating a purchase or sale. The same approach is beneficial in licensing, though perhaps not as useful as desired because there will seldom be identical technology and intellectual property packages.

LEARNING POINT 3: Negotiating a license agreement

1. Negotiation process

Negotiating a technology licensing agreement is the art of reaching an agreement where the licensor grants and the licensee acquires the right to use the licensor's technology on specified terms and conditions. The objective is to set the basis for a mutually satisfactory and ultimately rewarding future relationship. That is, a "win-win" outcome as opposed to a "win-lose" outcome (which, in effect, is a "lose-lose" outcome). The negotiation process involves four distinct phases: preparing, discussing, proposing and bargaining.

(1) The Preparation Phase

This is probably the most important, in that it is almost impossible to recover from, or overcome, inadequate preparation. Preparation includes all that has been discussed thus far.

a. Having gone through a preliminary analysis of its business objectives and decided that a licensing agreement would further that objective.

b. Establishing a team consisting of experts from the financial, legal and technical areas. Their respective roles and responsibilities must be clarified and each team member must understand the overall objective.

c. Preparing a summary of the key commercial issues to be covered in the license agreement and the position of the party on each such issue.

(2) The Discussion Phase

This is usually characterized by the licensor promoting the merits and the opportunities offered by its technology, and the potential licensee reviewing documentation and information under a confidentiality agreement.

(3) The Proposing Phase

In the proposing phase, the parties are exploring the possible relationship and the principal commercial terms. Key questions are being asked, assumptions tested, strategic objectives established and boundaries identified.

(4) The Bargaining Phase

In the bargaining phase, the question might become, "If we grant you an exclusive worldwide license, then you have to double the sum payable on signing the agreement", to which the licensee might respond "If we double the down-payment, then one half is to be credited against the future royalties payable to you on our sales of Licensed Products."

More References 3-1: NDA & LOI
1. NDA (Non-disclosure Agreements) (1) It is important to keep in mind that it is not sufficient to enter a licensing negotiation based on pure trust as on many occasions the negotiations do not necessarily result in a final license agreement. (2) To safeguard confidential information disclosed during negotiations it is standard practice to enter into a mutual non-disclosure agreement, also referred to as a confidentiality or secrecy agreement. 2. LOI (Letter of Intent) (1) A Letter of Intent(LOI) or Memorandum of Understanding(MOU) is an interim agreement spelling out the understanding of the parties before a formal license agreement is signed.

(2) Such an agreement generally states that the parties have embarked on and intend to continue negotiations with the intention of concluding a license agreement.

In the absence of clear intention to that effect it would be for the courts of a particular country to determine, subject to the laws of that country, whether such an agreement is legally binding on the parties or not.

2. The Guidelines of Negotiation

Guidelines are the principles that aim to provide the negotiator with a practical framework for the conduct of a negotiation. They are not rules, which if transgressed must mean the negotiation is at an end. Rather, the failure to follow or achieve a guideline is intended to alert the negotiator to the need to have an understanding of the current position and perhaps the need for additional or different actions.

(1) The golden guidelines of negotiation

a. Aim for a "win-win" outcome

License agreements invariably involve long-term technical, commercial and personal relationships and, it follows, that for the agreement to be successful all parties need to be satisfied with the agreement reached. A dissatisfied party will often go to extreme lengths to redress a perceived injustice and, when this happens, the grief, for one if not both parties, is likely to well exceed all the previous benefits. After all, all agreement is not inevitable and, in such a case, the "win-win" outcome would have been for the parties not to reach an agreement.

b. Generate variables

Generating variables or creating different options is another guideline for successful negotiation. A variety of different solutions are possible in solving a problem or in arriving at a mutually acceptable agreement. All of the key terms of the agreement are variables, and a little imagination can create additional variables, all of which can be creatively managed so as to arrive at an outcome that makes the parties feel that they have achieved an agreement that meets their respective business objectives.

c. If … Then guideline

   If …. Then guideline is otherwise known as the *Never Give Unless You Get* guideline. It is too easy for the inexperienced negotiator to agree to a proposal, and to then make a separate proposal – and be surprised when it is rejected. The negotiator has the power and the chance to explore and to link the issues and so achieve a better outcome. For example, “If we grant you an exclusive worldwide license, then you have to double the sum payable on signing the agreement.”

d. Establish the maximum (or best) position, and the minimum (or worst) position in respect of each issue.

   This is part of preparing for the negotiation and identifying and ranking the issues of importance to oneself, as well as anticipating those likely to be important to the other. This does not automatically mean that, if in the negotiation a minimum position is not being achieved, the negotiator should discontinue negotiations. Rather, being a guideline and not a rule, it requires the negotiator to be satisfied that, in agreeing to a position that is less than the minimum, there are good reasons. Perhaps new information has changed the minimum position which was established prior to the meeting. Or, on another issue the negotiator has achieved an outcome better than the maximum, and so overall and on balance the negotiator can accept a less than optimal outcome on this issue. Or this issue is not that important to the negotiator, and/or it can be justified because it is the last issue and overall agreement can now be reached.

e. Aim high, but protect your credibility

This is relevant to the previous guideline, and reflects that it is possible to accept a lesser position whereas the converse (to increase an offer) is usually impossible. If the official price for a new Mercedes Benz is $50,000 and a customer offers $35,000, it would be only a moment before the sales person was talking to the next customer. It is all very well to aim high, but not so high that the offer is not realistic and, in fact, jeopardizes, if not destroys, the customer's credibility. Rather, the customer might agree to pay $45,000, and then proceed to negotiate for the first year's services to be free, for the warranty to be extended by a year, for the radio/CD system to be upgraded, for a tow bar to be installed, and so on.

f. Trade variables that are cheap for you but valuable to the other party

This is the best outcome. The independent engineer's report on the second hand-Mercedes being purchased shows that repairs of up to $10,000 may be necessary. The customer might offer to proceed with the purchase if the repairs are carried out, and the garage might agree to do this because the mechanics have little work on hand and spare parts are few and are at wholesale prices. This is the best variable of all – it is valuable to one party but is cheap for the other party.

g. Everything is negotiable and you don't get the deal you deserve; that you get the deal you negotiate. Nothing is cast in stone.

(2) What should be avoided and what should be encouraged

a. The followings are to be avoided:

- Loss of credibility
- Surprises
- Arguing or threatening
- Underestimating the opponent

- Haggling
- Negotiating against yourself
- Lack of preparation

b. The followings are encouraged:
- Rationality: Even if they are acting emotionally, balance emotions with reason
- Understanding: Even if they misunderstand us, try to understand them
- Communication: Even if they are not listening, consult them before deciding on matters that affect them
- Reliability: Even if they are trying to deceive us, neither trust them nor deceive them but be reliable
- Non-coercive modes of influence: Even if they are trying to coerce us, neither yield to that coercion nor try to coerce them but be open to persuasion and try to persuade them
- Acceptance: Even if they reject us and our concerns as unworthy of their consideration, accept them as worthy of our consideration, care about them and be open to learning from them.

LEARNING POINT 4: Overview of a license agreement

1. Characteristics of a license agreement

(1) A license agreement is the outcome of a business strategy and the start of a business relationship

The parties clearly understand each other's business objectives, and appreciate that there is a mutual need to ensure that the licensing agreement is successful.

(2) A license agreement is a contract.

Meeting the legal requirements for a binding and enforceable contract is essential.

(3) Absence of any prohibition in a license agreement cannot be interpreted as a permission to do the omitted act.

Don't assume that a license is transferable or assignable, sub-licensable or encompasses a specific right/scope, simply because it does not expressly restrict the same.

(4) While licensing depends on the existence of proprietary rights there may be other important related issues.

Those related issues may be covered by other kinds of agreements such as agreements dealing with research and development, consulting and training, investment, manufacturing, distribution, sales, and so on.

More References 4-1: The factors that influence the royalty rate
The following factors influence the royalty rate that may be established: 1. Market Size 2. Competition 3. Product Development Stage 4. Patent Strength 5. Unique vs. Common Technology 6. Manufacturing Rights 7. Exclusive vs. Non-Exclusive 8. Worldwide vs. Regional Licenses 9. Deal Structure

10. Prevailing royalty rates in that particular industry technology (ballpark range)

2. Issues in a license agreement

(1) Main issues in a license agreement

a. Identification of the Parties

The Agreement should be made between the party who has the right to grant the license and the party who will be exercising that license. It must be clear as to who the licensor and who the licensee is. Additional details, including the addresses for each of the parties, the jurisdiction of incorporation (for corporate entities) and the effective date of the Agreement, may also be included in the identification section of the Agreement.

b. Definitions

The definition clause is the dictionary for the Agreement. As far as possible, each definition should be self-contained. There are three minimum terms that must be defined in a patent license.

- Licensed patents, any confidential information and know how, meaning "those that are subject of a license"
- Licensed products, meaning "those that may be produced, used, offered for sale, sold or imported by the licensee under the terms of the license"
- Territory, meaning the geographical territory "where the product may be used"

c. Subject Matter

It is crucial to be clear about the scope of a license, as the license grant forms the heart of the deal. It must be clear as to what is being licensed. For example, "the licensed subject matter" shall mean:

- Intellectual property rights: The "Intellectual Property Rights" shall mean all rights owned or otherwise held by Company X in, to or under patents or patent applications, whether domestic or foreign, and all divisions, continuations and continuation-in-part of any patent applications, and all patents which may issue from any patent applications, and all reissues, reexaminations, and extensions of patents, relating to Company X's technology.

- Technology rights: The "Technology Rights" shall mean all rights owned or otherwise controlled by Company X in, to or under technical information, know how, process, procedure, composition, device, method, formula, protocol, technique, software, design, drawing or data relating to the technology of Company X, which are not covered by Intellectual Property Rights, but which are necessary for the practice and full utilization of inventions at any time disclosed or claimed under the Intellectual Property Rights.

d. Extent and scope of the licensed rights

A license could be exclusive, sole or non-exclusive. A non-exclusive license, where the licensee is one of several licensees with whom the licensor has entered into agreements for the use and exploitation of the technology, is the preferred option of most licensors. By spreading the risks and rewards to several licensees, the licensor does not depend on the success of one licensee. He can maintain a better control over the technology and, by virtue of the fact that several licensees are using and exploiting the technology in several markets and perhaps in a variety of products, the technology is given a chance to further evolve and develop.

e. Field of use

The Licensee may be limited to distributing and selling the technology to a particular class of customers (such as airlines), commercializing the technology within a specific industry or industry segment (such as computer software), or using it for a particular purpose (such as research or incorporation into some other product or process).

f. Territory

The license may be limited to a particular geographic territory. For example, worldwide rights could be granted, or the rights could be for specific countries or even specific parts of countries (such as a state or region of a country). What is appropriate will be influenced by what the licensor is able to offer in terms of rights and what the licensee is able to take advantage of in a particular territory or region.

g. Technical assistance

Depending on the kind of technology being transferred, there is often an agreement to provide the licensee with technical assistance in the form of documentation, data and expertise.

h. License fees

Payments to the licensor for the acquisition and use of technology are usually classified as lump sums and royalties, and many agreements contain both types of payment.

- Lump sums: Lump sums are payable on the happening of a particular event. There may be one sum only, payable on signing the agreement. If there were no further payments, this would be considered a fully-paid-up license.
- Royalties: Royalties are regular payments to the licensor, which reflect the use of the technology by the licensee. As they link use with a monetary amount they can be a good reflection of the value of the technology to the licensee and, accordingly, royalties are the most usual type of payment in license agreements.

(2) The other issues in a license agreement

a. Effective date

Where foreign government approvals are required for a license agreement, the licensor's position will be protected by a condition precedent providing that the license will not come into effect until the license is approved in the form agreed between the parties. In this case, the licensor will not have lost his bargaining position in the event that changes are required in the license agreement, which favor the licensee.

b. Recitals

Properly drafted recitals are very useful for explaining the context and background of the license, and may assist in the interpretation of the Agreement.

c. Sub-license

The licensee, particularly an exclusive licensee, may wish to have the right to grant sub-licenses in its territory. If so, this needs to be specifically negotiated and stated in the agreement. The sub-license issues may include:

- To whom Licensee may sub-license
- What rights are sub-licensable and where
- What level of control Licensor wants over sub-licensees
- Whether prior written approval of the Licensor is required for granting of any sub-licenses, the choice of a sub-license, and the conditions upon which such sub-licenses may be granted; for example, the extent to which the terms of the sub-license should accord with those of the head license agreement.
- Whether or not the sub-license comes to an end when the head license is terminated or expires for any reason.

d. Improvements

When dealing with improvements, also known as versions, enhancements, and new models, it is important to define what is an improvement and, therefore, covered by the license, and what is a new technology or new intellectual property.

e. Most favored licensee

Where the license is non exclusive, the licensee may wish to include in the agreement a most favored licensee clause which in effect ensures that in the event that the licensor grants another licensee terms that are more favorable, then, by virtue of this clause, the present licensee would be entitled to terms as favorable as had been granted to the other licensee. In granting such a provision there should be clarity as to what is meant by "more favorable terms."

f. Best efforts

A paragraph stating that the licensee will use its best efforts to exploit the licensed technology is common in both exclusive and non-exclusive licenses. It would be desirable for the parties to agree on the meaning of best efforts, and what may constitute best efforts in terms of specific steps to be taken by the licensee.

g. Transferability of rights

A provision typically used in a license agreement states that the license shall ensure to the benefit of and be binding on the successors, assigns or other legal representatives of the parties. It is to be noted, however, that use of language of this type is uncertain in terms of its effect and could perhaps be in conflict with other provisions of the agreement that attempt to specify the assignability or lack of assignability of the license granted and the rights pertaining thereto.

h. Royalty stacking

The concept of royalty stacking arises from the risk that multiple patents may affect a single product. Royalty stacking arises when, in order to take a product to market, the developer of the product takes licenses from all of the owners of the patents which affect the final product. When the royalty payments are added together, the licensee may find itself with a non-profitable product. Hence it has become quite usual for licensees to insist on including anti-stacking provisions in license agreements. A typical anti-stacking provision states that the royalty rate payable to the licensor will be reduced if the licensee is obliged to enter into licenses with third parties in relation to the product. Such a provision can lead to a disparity between the expectations of the licensor as to the royalty it will receive from the licensee and the actual royalty the licensee is contractually obliged to pay.

i. Restrictions on payments under local law

The issue of exchange control restrictions and other local regulations that may affect the transfer of funds and therefore the remittance of royalties should be addressed by the parties and suitable solution be found at the time of the negotiation.

j. Inflation

The issue of inflation is effectively provided for where the royalty rate is expressed as a percentage of sales. Where, however, the royalty is a specific amount in a specified currency, it is usually reviewed regularly, say, annually or every two years, and adjusted, if the national law so permits, in accordance with an agreed consumer, manufacturing or other local index. Adjustments can also be made to lump sums payable on the happening of an event where, in particular, the occurrence of the event is distant and uncertain.

k. Financial administration

The financial administration provisions of the license agreement include obligations on the licensee to keep accounts and records, to report the results and pay the consequent royalties. The royalty reports, which might be required once, twice, or four times a year, might need to be certified by the licensee's chief financial officer or auditor.

l. Infringement

When all or part of the technology has the benefit of patent or other intellectual property protection, it is important to provide for what will happen if there is any infringement. There are two situations where infringement could occur.

- The first infringement situation

  The first is where a third party is using the protected technology but does not have a license. Here the licensee is facing competition and is likely to be at a financial disadvantage as the infringing competitor is not paying royalties.
- The second infringement situation

  The second infringement situation is where a third party claims that the licensee is using technology in respect of which the third party has obtained protection. In this situation, the licensee may be faced with the prospect of not being able to continue to use all or some part of the licensed technology.

m. Product liability

Product liability can have important financial consequences. The risk is that there might be injury or damage, to person or property, arising from a licensed product that is defective. The need is to identify the source of a potential defect and to assign responsibility accordingly.

n. Representations and warranties

Representations and warranties are statements or assurances about a matter or position relevant to the license agreement. One important distinction is that a representation is not usually a term of the agreement, whereas a warranty is a contractual term, the breach of which could entitle the injured party to terminate the agreement and sue for damages. A warranty is an assurance or promise in a contract, the breach of which may give rise to a claim for damages. It is essentially a minor term of a contract. Typical examples of representations and warranties include:

- The licensor owns the technology and has the right and authority to grant the license.
- The licensed material (e.g. text, software, and/or documentation) is original and has not been copied.
- To the best of the licensor's knowledge and belief, the licensed patents are valid and are not being infringed by any third party.

o. Licensor and Licensee obligations

The licensor is expected to take, for example, in a patent and know how agreement, all necessary action to transfer the technology and assist the licensee to commence commercial production. Similarly, the licensee is expected to successfully manufacture and market the licensed product in the territory.

p. Taxes

It should be made clear in the Agreement who is to absorb and pay relevant taxes, including any applicable sales, customs and excise, or withholding taxes. Withholding taxes are of particular concern in international licensing arrangements. If one party is obligated to assume responsibility for withholding taxes, the Agreement usually includes a provision which requires the other party to provide reasonable assistance in respect of any possible refunds.

q. Waiver

A waiver clause in a license agreement means that a party does not lose its rights because it does not enforce those rights. Thus, if a licensor was entitled to give notice of termination due to nonpayment of royalties, but overlooked or ignored the breach, the licensor could still give notice in respect of another breach of that obligation. The waiver clause in effect prevents the application of the legal concept of estoppels, i.e. the earlier tolerance or oversight does not prevent the licensor from subsequently enforcing its rights.

r. Force Majeure

A force majeure clause in a license agreement addresses intervening circumstances beyond the control of a party, which prevent that party from carrying out its obligations. War, strikes and fire are the types of occurrences envisaged, and the benefit of the clause is that the time to carry out an obligation may be delayed until the *force majeure* circumstance ceases or is removed.

s. Anti-competitive practices

When entering into a licensing agreement it is important to keep in mind that if certain business practices are incorporated, the agreement may, depending on the national laws of the country or countries in question, be considered illegal if tantamount to being anti-competitive. Some examples of practices that may be considered unlawful depending on the particular circumstances of the agreement are obliging a licensee to accept certain products or services in addition to the proprietary technology (tie-in, bundling), prohibiting the licensee from dealing with certain enterprises, attempting to fix the prices of products incorporating the licensed technology, territorial restrictions, cross licensing and patent pooling.

t. Government regulations

When considering entering into a licensing agreement with a foreign partner it is important to verify the existence of various government regulations that may affect it. For example, most countries would at least require the registration of a licensing agreement with the relevant authorities in that country but there may, in addition, be an approval process that must be followed for engaging in that kind of activity in that country. In the licensor's own country there may be regulations that restrict or make conditional the dealing with certain technologies for security or other reasons.

u. Disputes

When negotiating the license agreement, parties should be aware that disputes might arise and provide means for resolving them. Built in flexibility for amendments should provide means for resolution at first resort. Failing which, mechanisms for dispute resolution must be provided for. When drafting dispute resolution clauses, parties can draw from several options. Traditionally, parties have often agreed to resolve disputes through litigation in a specified domestic court. Increasingly, however, parties opt for alternative dispute resolution (ADR) procedures, such as arbitration and mediation, or mediation followed by arbitration.

<Advantages of ADR procedures>

- *A single procedure*. Through ADR procedures, the parties can agree to resolve in a single procedure a dispute involving intellectual property rights that are protected in a number of different countries, thereby avoiding the expense and complexity of multi-jurisdictional litigation, and the risk of inconsistent results.
- *Party autonomy*. Because of its private nature, ADR procedures afford parties the opportunity to exercise greater control over the way their dispute is resolved than would be the case in court litigation.
- *Neutrality*. ADR procedures can be neutral to the law, language and institutional culture of the parties, thereby avoiding any home court advantage that one of the parties may enjoy in court-based litigation, where familiarity with the applicable law and local

processes can offer significant strategic advantages.

- *Confidentiality*. ADR proceedings are private. Accordingly, the parties can agree to keep the proceedings and any results confidential. This allows them to focus on the merits of the dispute without concern about its public impact, and may be of special importance where commercial reputations and trade secrets are involved.
- *Finality and enforceability of arbitral awards*. Unlike court decisions, which can generally be contested through one or more rounds of litigation, arbitral awards are not normally subject to appeal.

v. Indemnities

Generally, an indemnity is an undertaking by one person to meet a specific potential legal liability of another. An indemnity entitles the person indemnified to a payment if the event giving rise to the indemnity takes place. Unlike a claim for breach of warranty there is no need for the indemnified party to establish that he has suffered loss.

w. Release

If a license is being entered into as part of a settlement to infringement proceedings, it may be necessary to include in the grant section a release against infringement that was alleged to occur prior to the date of the Agreement. Although most properly drafted grant provisions will make it clear that the rights granted to the licensee are conditional upon the licensee's compliance with its obligations under the Agreement, this is particularly important in a release-type grant if the licensor intends to retain the right to recover damages for the past infringements upon any future breach by the licensee of the Agreement. This would likely only apply where specific consideration for the release has not been provided.

More References 4-2: Confidential Information
YeraCAM and Tolmnex each agree that all information contained in documents marked “confidential” which are received by one party from the other party, and all information indicated to be Confidential Information in Sections X and Y(collectively, “Confidential Information”) shall be received in strict confidence, used only for the express purposes set for in this Agreement, and not disclosed by the recipient party(except as required by law or court order), its agents or employees without the prior written consent of the other party, unless such Confidential Information. 1. was in the public domain at the time of disclosure; 2. later became part of the public domain through no act or omission of the recipient party, its employees, agents, or permitted successors or assigns; 3. was lawfully disclosed to the recipient party by a third party having no obligation to the disclosing party; 4. was already known by the recipient party at the time of disclosure; 5. was independently developed by the recipient without use of or access to such Confidential Information; or 6. is required to be disclosed to a government agency.

LEARNING POINT 5: Managing a license agreement

1. Implementing and managing the agreement

A license agreement is a continuous relationship over a fairly long period of time between two parties working towards a mutually-rewarding outcome. To ensure that the relationship is rewarding to the parties, it is important that they deliver on their respective obligations arising from the agreement.

It is important that all of these obligations and how they may be implemented are clearly specified in sufficient detail in the agreement. They imply both for the licensor and licensee costs in terms of time spent and additional human resources deployed. Doing so is indispensable for the survival, smooth running and sustainability of the agreement.

Here are several issues in managing the relationship in a license agreement:

(1) Technical assistance

Technical assistance can greatly reduce the time required by the licensee to move the licensed technology into production. The obvious benefits are that the licensee generates income more quickly and the licensor earns royalties much sooner. While technical assistance benefits both parties, the licensor will need to have the resources available to fulfill this responsibility.

Common elements of the technical assistance include the following:

a. Plant visits and training

The licensee obtains rights to on-the-spot training of its technical engineers, in the licensor's facilities, that are developing or using the licensed process and/or making and selling the licensed product.

b. Direct assistance

The licensee may obtain the right to have site assistance (within the licensed territory) from the licensor's technical personnel to the solve problems related to commercial use of the licensed process and/or the making and selling of the licensed product.

c. Consultation

This is the right of the licensee to contact the licensor by mail, telefax, telex or telephone through representatives appointed by each party.

(2) Tangible items

The agreement should specify how the licensor will bill and collect for any machinery sold to the licensee, and for such items as operating manuals, blueprints, drawings, manufacturing specifications, test equipments or devices supplied by licensor to licensee. Such charges may apply for quantities that exceed an agreed-on level to be exchanged initially for no added payment.

(3) Reporting

Licensees are typically obligated to send a royalty statement or report with each royalty payment, although if royalties are payable on a relatively frequent basis, reports may only be required at less burdensome intervals, such as quarterly or annually. A licensor may also request that the reports be certified by the licensor's auditors or chief financial officer.

The reporting clause usually requires the licensee to keep and maintain complete and accurate financial and production records relating to all products manufactured, sold, used, returned and invoiced (if such products relate to the licensed intellectual property) in sufficient detail to allow the licensee to verify such records. Ancillary to the reporting obligation is a right of the licensor to inspect and audit these records, or allow an independent third party to perform an inspection and audit.

(4) Auditing

Most audit clauses limit the licensor in the exercise of its rights to a specified frequency (e.g. once per year) and only upon reasonable notice and during regular working hours. The cost of any audits are normally borne by the licensor, unless it finds a discrepancy between the royalty amounts actually paid to it and the amounts it should have received, in which case the licensee is required to pay for the audit. Licensors should make it a policy to conduct periodic audits as is their right, as regular audits keep a licensee honest by removing temptations.

2. Termination and post termination issues

(1) License agreements come to an end in the following two ways:

a. The period of the agreement expires or an event agreed to trigger termination occurs. For example, the term may be fixed as ten years from the effective date and on the completion of the ten years the agreement ends. Or, it expires on the occurrence of an event such as the expiration of the last of the licensed patents or, sooner, if it is determined by a court or administrative agency of competent jurisdiction that the last of the patents within the "Licensed Subject Matter" is invalid or unenforceable.

b. The agreement is terminated by one party before the agreement has expired. The right to terminate the agreement is usually set out in detail and relate to a failure to perform in some way amounting to a breach of a condition of the agreement, for example, failure to make payments, bankruptcy or insolvency.

(2) After expiration or termination of the agreement

a. Know-how or confidential information

When an agreement expires or is terminated by the licensor, will the licensee return or continue to use the know-how or confidential information? For example, "Return of Confidential Information: Upon termination of this Agreement by Company B pursuant to Section [*], but not upon expiration or termination of this Agreement by Company A pursuant to Section [*], Company A shall promptly return to Company B any Confidential Information of Company B received from Company B prior to such termination, and Company A shall no longer be entitled to use any such Confidential Information for any purpose."

b. Sub-license

Are there any sub-licenses or other rights that have been granted to third parties and do they continue after termination?

c. Other clauses

For example, maintaining confidentiality, continuing rights to use the other party's improvements, access to records for a particular period.

For example, "Protection of Confidential Information: Each party's obligations of confidentiality, non-use and non-disclosure set forth in Section[*] shall be fulfilled by using at least the same degree of care with the other party's Confidential Information as it uses to protect its own Confidential Information. This obligation shall continue in full force and effect during the term of this Agreement and thereafter for a period of three (3) years."

QUIZ

Q1. Identify the incorrect statement:

1) A license transfers the right to use IP rights but not its ownership.

2) For some businesses licensing of their IP is their only business.

3) A due diligence exercise should only be conducted by a licensor.

4) You don't get the deal you deserve, you get the deal you negotiate.

Answer : 3)
A due diligence exercise which is the performance of an investigation prior to entering into a licensing relationship (and may well be useful to do from time to time even during the relationship) should be done by both parties. It is important that both parties are well informed of their partner, the business, the industry, competing products and technologies etc. The better informed the parties are, the better the agreement and finally the relationship would be.

Q2. Identify the incorrect statement:

1) If something has not been prohibited in the agreement it means it is allowed.

2) A licensee could be granted the right to use the IP rights of the licensor worldwide.

3) A licensee could be obliged to make a report with every royalty payment.

4) Even after an agreement has terminated there may be certain clauses that remain valid.

Answer : 1)
It cannot be assumed that simply because something is not prohibited in the agreement that it is allowed.

Q3. Identify the incorrect statement:

1) A business should not license the intellectual property which is integral to its business.

2) A business could grant a license to an infringer.

3) A business may enter into license agreements during its interactions with contractors, consultants and in the context of a strategic alliance.

4) A business may usefully license its IP rights that it does not use.

Answer : 1)
A business may license its IP which is integral to its business by licensing its use in another territory or field of use.