LICENSING: THE LEAST YOU NEED TO KNOW

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Virtually all companies are engaged in licensing both from and to other companies. Despite the ubiquitousness of the licensing mechanism, many even sophisticated persons are confused about: (i) just what a license is; (ii) what can be licensed; (iii) the most common problems associated with intellectual property licenses; (iv) the fundamentally important provisions that must be addressed in license agreements; and (v) the numerous different types of license agreements. This article addresses each of these points, in order.

Just What *Is* A License?

A "license" is an agreement to do something with someone else's property which, were it not for the license, could be legally prevented and/or could give rise to a legal cause of action. In addition, licenses are characterized by their immense flexibility when compared to a "sale." Since in a license transaction the licensor retains some rights, there are, literally, an infinite number of variations for the terms of the license.

While the infinite flexibility provided by a license compared to a sale is extremely advantageous, it is also a negative since it compels the parties to address numerous issues that need not be addressed in a sales transaction.

Consequently, while licensing provides a tremendously useful tool, license transactions are fraught with traps for the unwary because there are simply so many issues that can, and in many cases should, be addressed.

What Can Be Licensed?

Any piece of intellectual property can be licensed. Since a license is by definition a license to do something that, without the license, would constitute a violation of another's rights, in most cases licenses cover some form of intellectual property that if used without the license, would give rise to a private action for some form of intellectual property infringement. The principal areas of intellectual property are patents, trademarks, copyrights, and trade secrets. Intellectual property also covers certain computer chip designs (i.e. "mask works") and other items.

In addition, certain things are often licensed even though their manufacture or sale without the license would not give rise to a cause of action for intellectual property infringement. For example, for products that, while not containing protectible intellectual property, require substantial resources to produce or sell (such as specialized, expensive equipment), a license to use another's equipment may be the most efficient way to structure the relationship.

COMMON PROBLEMS SPECIFIC TO INTELLECTUAL PROPERTY LICENSES

Trademark Licenses. The essence of a trademark license is the right to use another's trademark or service mark to identify particular goods or services. For a trademark license to be enforceable by the licensor against the licensee, the licensor must retain quality control over the goods or services sold by the licensee that use the licensed trademark. If quality control is not retained or exercised by the licensor, a "naked license" results, which can cause the licensor to lose all rights to its trademark.

If the trademark license also specifies a method of doing business that the licensee must adhere to in connection with the sale of the products and/or the delivery of the services, a trademark license has likely become a "franchise." All "franchises" must be registered with the applicable state regulatory authorities, and extensive disclosure concerning the franchise and its operations must be provided to prospective franchisees (in this case, the licensee). Because the "quality control" requirement for a valid trademark license can easily, and often inadvertently does, cross over into the specification by the licensor to the licensee of a manner of

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doing business, it is extremely easy for a trademark license to become an unregistered "franchise" which can produce enormous adverse consequences to the licensor.

Copyright Licenses. The most common problem with copyright licenses is the failure to very clearly specify what can be done with the copyrighted work beyond its use in exactly the form provided by the licensor to the licensee.

Copyrights are unique among the intellectual property rights in that they provide six different exclusive rights, including the rights: to make copies, to adapt (i.e. to make "derivative works"), to distribute, to perform, to display, and for sound recordings, to transmit digitally. Ambiguous license grant language in a copyright license can cause tremendous difficulties for the licensor and the licensee if that language fails to address the various sub-rights that make-up a "copyright."

Ambiguous or incomplete license grant language is of particular concern in software license agreements, since software is most frequently protected by copyright. In many cases, the utility of a software license will only exist if the licensee has some right to modify or adapt the licensed software. If the license grant did not provide it, any changes whatsoever by the licensee to the copyrighted work would constitute copyright infringement.

The same analysis pertains to all forms of copyrights, including images, video, music, textural works, and any other work that is "creative expression" of an author, and is "fixed in a tangible medium of expression." That is, the scope of the licensee's rights to modify, add to, and integrate other works with, the copyrighted works must be addressed in detail in the license agreement to prevent disputes in the future.

Trade Secret Licenses. The license of trade secrets and confidential information requires extreme protective measures be clearly articulated in the license agreement because even one inadvertent disclosure of a trade secret or piece of confidential information can cause that secret information to lose its protected trade secret status.

Trade secrets are one of the most powerful types of intellectual property protection because their period of protectiblity is potentially perpetual. Unlike patents and copyrights which have a limited term, and trademarks which must be continually used to maintain their protectibility, trade secrets remain protectible intellectual property so long as: (i) the necessary steps are taken to maintain confidentiality of the secret, and (ii) the secret has value by virtue of its not being generally known to the public. The classic example of trade secrets' unique value because of their unlimited term of protection, is the Coca-Cola recipe. While the recipe would have been patentable, had it been patented, rather than protected via trade secret, the recipe would have lost patent protection after 17 years and thereafter become public information. Consequently, if a license agreement covers trade secrets in any way, extensive protective measures must be set forth in the license agreement.

In addition, because trade secret protection can be perpetual, the "term" of a license agreement covering trade secrets must be very carefully drafted to ensure that the term does not apply to the period of time during which the licensee must maintain confidentiality of the trade secrets. That is, licensees must be required to maintain that confidentiality into perpetuity, notwithstanding the termination of the license agreement for any reason whatsoever.

Patent Licenses. The most common problem with patent licenses is the failure to recognize that a patent does not grant the patent owner the right to make anything, but rather grants the right to exclude others from making, using, or selling the invention. Thus, a license grant that purports to grant the licensee the right to make, use, or sell a particular invention, is de facto invalid. Moreover, such language may constitute a violation of the licensor's representations and warranties if a representation is made that the licensor has the right to grant the license.

The only proper way to license a patent is to state that the patent owner/licensor is granting the licensee protection from infringement lawsuits by the licensor for the licensee's making, using, and/or selling the patented invention.

Patent licenses can also be invalid if they purport to cover terms longer than the remaining term of the patent, or to cover a scope or field of use larger than the patent provides.

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Combination Licenses. Due to the world's continually expanding complexity, many license transactions cover more than one piece of intellectual property, although the parties often don't recognize this.

To the extent more than one form of intellectual property is licensed by the licensor to the licensee, then specific licenses for each of those components must be provided, otherwise the lack of specificity is likely to result in a dispute between the parties concerning the scope of use for the unaddressed pieces.

Frequently, one piece of intellectual property will have substantially different rights and limitations associated with it, than another piece of intellectual property being licensed with the first. A common example is the right to make derivative works of a particular portion of the computer software that is licensed, but not for other portions. Similarly, if patented technology and copyright protected technology are both licensed in one transaction, the right to enhancements and modifications to each of the pieces of technology may be very different.

PROVISIONS THAT SHOULD BE ADDRESSED IN ALL LICENSE AGREEMENTS.

The following is a list of the most important terms that should be addressed in virtually all license agreements:

Scope of the License Grant. What, very specifically, does the license cover? An often overlooked element of the "scope" of the license is whether or not the subject of the license can be used for any and all purposes, or only for specific products or purposes.

If the license includes the right to "make" something using the licensor's intellectual property, does it also include the right to "have made" the particular item? Can the licensor export? A detailed analysis of what the license can and cannot due must be undertaken.

For copyrightable works (such as text, images, audio, video, and computer software), does the license include the right to reproduce, to prepare derivative works, and to distribute by any and all means? Frequently the licensor would like to limit distribution to specific distribution mechanisms or channels, had it thought of it.

Licensors must always consider the effect of every subsequent license grant on previously entered into license agreements. An inadvertent overlap of licensed scopes which violates a representation or warranty in either the old or the new license agreement can produce devastating consequences.

Licensors must also consider whether or not they possess all the rights necessary to grant the scope of license that they propose to grant to the licensee. This is often the case in software transactions because the complexity of newer software programs frequently requires that they contain disparate pieces of software licensed by the licensor itself from other third parties (or may have required the use of third party development software which contains restrictions on subsequent licensing of the software that the licensor proposes to license). Furthermore, if the software contains open source code, it may not be licensable at all.

Similarly, depending on how the license grant language is drafted, it can inadvertently cover items which the licensor may acquire in the future. In those cases, were such an anticipatory license for future components granted, and the licensor's subsequent acquisition of those licensed rights from a third party were not to include the right to sublicense to others, the licensor would be in the unenviable position of immediately violating the license agreement at issue.

Exclusive or Nonexclusive License? This issue pertains to the "main" technology, software, and intellectual property being licensed, but also applies to any sublicensed components, and future enhancements, modifications, and new products created by the licensor. The issue must be addressed for each of those matters.

In many instances, it may be appropriate to cause an exclusive license to transform into a nonexclusive license in the event licensee does not satisfy certain requirements or meet certain milestones.

Delivery vs. Acceptance Standards. If the licensee is not already completely comfortable with the intellectual property, software, or other technology that will be delivered by the licensor under the license agreement, then acceptance procedures must be specified to protect the licensee. Unfortunately, however, numerous license agreements get drafted without very specific and understandable acceptance criteria. If payment, or the performance of a duty, by the licensee is triggered merely by "delivery" of the licensed

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element, rather than by clear and specific acceptance criteria, disputes will invariably arise.

In many cases, acceptance criteria can only be specified, and determined to have been satisfied, by the technical people within the licensee's organization. Consequently, such persons must be involved in the license agreement drafting.

Modifications and Enhancements. Does the licensee have the right to modifications, enhancements, or entirely new products developed by the licensor that include or relate in any way to the licensed intellectual property or technology? Similarly, does the licensee have the right to make such modifications and enhancements? If yes, who owns them?

This section is immensely important, but often not given the attention it deserves. Many licensors fail to see how the grant of such rights can impair their ability to do other transactions in the future. Similarly, the licensee's failure to obtain enhancements, improvements, and other technologies from the licensor may put it at an extreme competitive disadvantage while having locked it in to a particular form of technology or software platform.

Some of the ways to address this complex issue include having the licensee pay a portion of the licensor's development costs for the licensee's right to receive the new items, or a right of first refusal in the licensee for new items.

Representations and Warranties. Among the issues that need to be addressed in licensing transactions' representations and warranties sections include: (i) licensor's ownership or right to grant the licenses; (ii) the validity of the intellectual property being licensed to the licensee; (iii) noninfringement and no violation of third parties' rights; (iv) the territorial scope of the representations and warranties; and (v) other matters normally addressed in other forms of agreements.

Limitation of Liability. This is an extremely important section of a license agreement that is often either given short shrift, or is treated as boilerplate. Limitation of liability from the licensor's perspective begins with addressing very clearly the representations and warranties that will be made in the first instance, and then crafting them carefully. Furthermore, an analysis must be undertaken to assess whether or not a warranty is appropriate for only some of the licensed elements.

In addition, the limitation of liability can cover many forms, including limiting liability to breaches of particular representations or warranties, providing indemnity against third party claims for breaches of certain of the representations or warranties, or going even further and providing a defense in the event of any third party claims against the licensee.

From the licensee's perspective, liability limitations should be kept separate from warranty disclaimers so that there is no possible interpretation that the liability limitations apply only to breaches of warranty claims.

To provide complete protection for the licensor, limitations of liability should reference non-contract claims (such as negligence, recklessness, and willfulness) in addition to contract claims arising out of the language of the agreement.

While most license agreements do address the need to limit liability for consequential, incidental, and punitive damages, many agreements fail to address the limit of "direct" damages. The parties may often be able to agree on a number that can essentially split the risk between the parties and allow a transaction to be accomplished that would not otherwise get done. A variation on such a limit would be liquidated damages for particular breaches or other matters giving rise to liability.

Another method of limiting liability is to provide that certain rights will be lost, rather than damages being payable, in the event of certain violations of the agreement's terms.

Indemnity. Most frequently, indemnity is broken out into indemnification for intellectual property infringement on the one

hand, and indemnity for all other types of third party claims. An analysis needs to be undertaken concerning whether or not indemnification is appropriate in each instance. Since intellectual property infringement indemnity is more frequently provided, a detailed analysis of the intellectual property licensed, and the scope of use authorized, needs to be carried out to ensure that the infringement indemnity is not too broad or too

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narrow.

For any type of indemnity, it is critical to specify who controls the defense of the litigation, and the right to enter into settlement. If the indemnitee has the right to control the litigation, a further analysis needs to be done to determine whether or not it would be appropriate for the indemnitee to also be able to enter into a settlement without first obtaining the indemnitor's consent.

Indemnity provisions also need to be drafted carefully so they are not in conflict with the general liability limitations contained elsewhere in the agreement. Most often, there will indeed by a general liability limitation but no cross reference to that section in the indemnification section, thereby causing a fatal ambiguity.

Protection of the Intellectual Property/Technology. This section must address in detail confidentiality restrictions, limitations on reverse engineering (particularly for software license agreements), and restrictions on leasing software to an ASP service bureau activity.

Regarding confidentiality, often the license agreement's terms, no matter how well-drafted, will not be sufficient to protect the licensor who is licensing trade secret and confidential information. *Actual assurance* that the licensee's employees have signed confidentiality agreements, and that the licensee has adequate confidentiality procedures in place (such as secure premises, the use confidentiality labels, and exit interviews with departing employees), may be necessary to ensure that as a practical matter the licensor's trade secret information will remain such.

TYPES OF LICENSE AGREEMENTS

Because of the virtually infinite flexibility that licensing provides compared to purchase and sale transactions, a very large number of types of license agreements has developed. Among those types of agreements are:

Development Agreements - These agreements almost always include license rights back to the developer for some or all of the intellectual property that has been developed. This is particularly likely in software development transactions;

Marketing License Agreements - These agreements generally grant the licensee the right to market the licensor's products and/or services, and include obligations on the licensee to assist the licensor in servicing customers;

Distribution, Dealer, and OEM Agreements - These forms of agreement contemplate the licensee adding value to the licensor's product by combining the licensor's products or services with its own products and/or services which are then offered directly to end users as an integrated system;

Implementation and Integration Agreements - These forms of agreement often license technology and intellectual property for purposes of allowing the licensee to install, test, integrate, and sometimes customize intellectual property, technology, and software to produce an entire system;

Outsourcing and Data Processing Agreements - These agreements can combine a very significant number of rights and restrictions because of the substantial amount of intellectual property transferred by the licensor to the license and the corresponding risks of doing so;

Evaluation Agreements - These agreements are critical, and often overlooked. They can be essential to facilitating larger transactions by allowing the prospective licensee to sample the intellectual property or technology (and particularly, software);

End User License Agreements – These Agreements govern what the end-user can do with software or other technology, and often are implemented in a "click-wrap" or "shrink-wrap" manner;

Support, Maintenance and Help Desk Agreements - These are almost essential in software license transactions;

Software Escrow Agreements, Disaster Recovery Services, and Backup Licenses - Often overlooked, but critically important, are license agreements that deal with worst case scenarios including disasters, bankruptcy of the licensor, and similar untoward circumstances;

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Electronic Database Subscription and License Agreements - More and more, databases are becoming protectible, and indeed have received statutory protection in Europe. Consequently, to the extent that databases can be protected via copyright, trade secret, or other intellectual property means, it can have immense value and therefore the license terms should be drafted accordingly;

Manufacturing License Agreements - These agreements deal with the myriad issues related to one party manufacturing a product to another party's specifications; and

Partnership and Joint Venture Agreements – Strategic alliances can be effected via a formal partnership in which the parties' contribute money or intellectual property to a new entity. Often, however, the transaction is structured through a combination license agreement.

CONCLUSION

As licensing becomes the dominant form of agreement in commercial transactions, it is incumbent on business persons and their lawyers to be aware of the numerous issues that should be addressed in license agreements. What many people fail to realize is the need to have business, technical, and legal persons involved in the negotiation and drafting of the license agreement because of the nature and breadth of the issues that will be presented. All of the most common problems encountered in license disputes can be prevented if the time is taken up front to go

through a detailed checklist of the issues that must be addressed, and then thorough drafting of the necessary language is performed. Attempting to use a previously drafted license agreement can serve as a useful starting point, but blind reliance on that agreement alone is a recipe for disaster.

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