

Anatomy of an IP License Agreement

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Introduction – Topics Addressed.

1. What makes license agreements distinctive?
2. License grant provisions
3. Royalties
4. Warranties
5. Issues presented by joint development and joint ownership
6. Allocating rights and obligations for prosecution and enforcement

What makes license agreements distinctive?

- 1. The Crystal Ball.**
 - a) ongoing long-term relationship
 - b) licensor and licensee will be bound together into the future
 - c) tension -- need for flexible contractual language versus need for precision
- 2. Highly Technical Subject Matter**
- 3. Amorphous Subject Matter**
- 4. Specialized Legal Concepts**
- 5. Many Purposes**
- 6. The Usual Range of Commercial Issues**

License Grant Provisions

1. Scope of grant
 - a) The grant language of any license needs to be highly customized to fit the specific circumstances.
 - b) Key terminology:
 - present grant language
 - verbs specifically addressing granted rights and subject matter (e.g., patent terms versus copyright terms)
 - c) Specify identities of the licensor, licensee and permitted users
 - d) Exclusivity
 - e) Duration
 - f) Licensed field/ Licensed channel

License Grant Provisions (cont'd)

1. Scope of grant (cont'd)
 - g) Geographic territory
 - h) Sublicensable/transferable
 - i) Definition of licensed IP
 - j) Duty to commercialize

Royalties and Other Consideration

1. No maximum limit in IP law on setting the royalty rate – whatever licensor can negotiate
2. Collection of royalties remains subject to:
 - a) antitrust limitations
 - b) patent misuse
 - c) first sale doctrine
 - d) invalid or worthless IP
 - e) state law restrictions on unconscionability – may be preempted by federal law

Royalties and Other Consideration (cont'd)

3. Compensation structures
 - a) equity in licensee
 - b) one-time up-front lump sum
 - c) annual fee with no ongoing royalty
 - d) milestone payments with or without ongoing royalty
 - e) ongoing running royalty alone
 - f) ongoing running royalty with advance or minimum annual commitment
 - g) most common – ongoing running royalty - % of net sales
 - h) combination of above subject to a cap, after which license becomes paid-up

Royalties and Other Consideration (cont'd)

4. Determining the rate – value of IP

a) Factors:

- *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1119-20 (S.D.N.Y. 1970), modified and aff'd, 446 F.2d 295 (2d Cir.) – much-cited approach to setting royalties in court awards – for willing licensor and licensee

b) Market approach – focus is on present value of future benefits by looking to market

c) Cost approach – focus is on the amount of money required to replace the subject property

d) Income approach – focus is on income-producing capability of the property

Royalties and Other Consideration (cont'd)

5. Royalty base

- a) Revenues – specify calculation (gross vs. net -- specify and cap deductions)
- b) Profits – specify calculation
- c) per unit, e.g., pieces, cycles, seats, clicks, etc. – noncompliance is a common problem in software vendor audits
- d) what connection to the licensed IP?
- e) sales to related entities/not arm's length
- f) sales under value in exchange for other items of value

Royalties and Other Consideration (cont'd)

5. Royalty base (cont'd)
 - a) returns/samples/demonstrative products
 - b) cross licenses where consideration is another license
6. Cap – maximum royalty amount
7. Duration
 - a) Last-to-expire patent
 - b) Patent misuse as equitable defense
 - c) Copyright misuse -- also possible for software according to some case law

Royalties and Other Consideration (cont'd)

8. Royalty stacking provisions
9. Payment periods, royalty reports -- typically quarterly
10. Other financial terms:
 - a) Late fees
 - b) Exchange rates
 - c) Inflation adjustment

Royalties and Other Consideration (cont'd)

11. Licensor right to conduct audit

- significant risk for licensee of disruption and additional fees and damages for noncompliance with license terms

Warranties

Possible IP-specific warranties by licensor:

- a) Valid title to licensed IP
- b) No misappropriation of confidential or trade secret information
- c) validity or scope of patent rights – licensor should almost always refuse to give this warranty
- d) licensor has not granted any other license (subject to exclusivity terms)
- e) licensee does not need any other license or right which is owned by Licensor that is necessary or useful for Licensee to exercise its license rights

Warranties (cont'd)

Possible IP-specific warranties by licensor: (cont'd)

- f) IP (e.g., software code) will operate in all material respects in conformity with the specifications and documentation
- g) attainment of service levels, e.g., for hosted software
- h) services performed in professional and workmanlike manner by qualified, competent and capable personnel familiar with the services and having the proper skill, training, and background to perform the services

Warranties (cont'd)

Possible IP-specific warranties by licensor: (cont'd)

- i) documentation for software – complete, in English, permits reasonably skilled operator to use and operate the software – licensor will argue this is vague
- j) updates vs. enhancements – can be difficult line-drawing exercise
- k) defects in design, materials, workmanship – for software, licensor will want to limit to medium on which code is delivered; licensee will want to be expansive
- l) compatibility (with prior and later versions and with operating systems, etc.
- m) data integrity on transfer

Warranties (cont'd)

Possible IP-specific warranties by licensor: (cont'd)

- n) problems in software code – malware, open source
- o) noninfringement of third-party IP rights
- p) no pending or, to the best of licensor's knowledge, threatened litigation or claims
- q) fitness for particular purpose
- r) all licensor employees and contractors are subject to confidentiality agreements with assignments of rights to licensor
- s) contrast – “As Is” – no warranties – need to expressly disclaim warranties of fitness for purpose and noninfringement

Issues Presented By Joint Development

1. Improvements / Newly Developed IP
 - a) Is licensee permitted to make improvements? *E.g.*, derivative works of copyrighted materials, software code
 - b) Who owns improvements?
 - c) Does non-owning party receive a license to use?
 - d) Is such a license to use subject to compensation?
 - e) complicates prosecution, enforcement, infringement, royalties

Issues Presented By Joint Development (cont'd)

2. Problems of Joint Ownership of IP

a) References:

- Yang, Joseph, Patent and Technology Licensing, in Advanced Licensing Agreements, by Practising Law Institute 2006, pp 11-37. Also printed in The Practical Lawyer, February & April 2005.
- Moore Gary H., Joint Ventures and Strategic Alliances: Ownership of Developed Intellectual Property – Issues and Approaches, The Computer & Internet Lawyer, Vol 24 No 9, September 2007 pp 5-20.

b) Joint ownership is common

c) Problems of joint ownership of US patents, of multiple IP types, of foreign IP

Issues Presented By Joint Development (cont'd)

2. Problems of Joint Ownership of IP (cont'd)

f) Specific risks:

- Cause of action for breach versus availability of action for injunction and invalidity of attempted actions
- third-party transferee may be a bona fide purchaser or licensee

g) Strategies:

- Allocate ownership to one party, with detailed license terms providing for each party's right to use
 - By inventorship
 - By derivation
 - By field of use
 - Combination

Allocating Rights And Obligations For Prosecution And Enforcement

1. Ownership
 - a) Acknowledgment that licensor is sole owner
 - b) Nothing in agreement conveys rights except for license rights specifically provided
 - c) Licensee won't challenge licensor's rights in underlying IP
 - d) Further assurances

Allocating Rights And Obligations For Prosecution And Enforcement (cont'd)

2. Prosecution

- a) Maintenance of the licensed IP
- b) Follows from roles of licensor and licensee – who has what rights to own, use, benefit from the IP and how does it relate to other IP of that party

3. Infringement – Actions Against Third Parties

- a) Grant to licensee of right to sue
- b) Require licensor to sue
- c) Allocation of expenses and damage awards
- d) Duty to provide notice

Allocating Rights And Obligations For Prosecution And Enforcement (cont'd)

4. Infringement – Defense of Actions Brought by Third Parties
 - a) Is licensee buying technology package or covenant not to sue?
 - b) What measures is licensor required to take (obtain license, replace with noninfringing IP, refund fees)
 - c) Do those measures make licensee whole?

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