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Licensing 101: Get it done right from the start

The world of licensing may seem complex and esoteric, but a license really is just a contract. It is a crucially important contract if intellectual property is an important company asset. Here are a few simple questions and answers to get you on the right track.

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• Why choose a license and not a sale? In a sale, the seller loses control over the technology once the sale is consummated. When you have parted with the title to the technology, the anti-trust laws say that you cannot tell the purchaser what to do with the technology. If you “sell” software, for example, you cannot forbid the purchaser from making copies, selling the copies and making improvements to the software.

With a license, you can impose restrictions on the use of the technology, including, for example, territorial restrictions, limits on the number of users and the licensee’s ability to make modifications. Importantly, if the licensee does not perform according to the license terms, you can terminate the agreement.

• What is the precise subject of the license — a patent, the copyright for software or a trademark?

• In what “field of use” can the technology be used?

• Is the license exclusive or non-exclusive? Is the licensee the only user of the licensed material, or has the licensor granted

licenses to other users? As a licensee, will your competitors be able to license the same material?

• In what geographical or business locations can the technology be used?

• Payment terms. Is the license paid-up from the outset? Are the fees based on usage or number of users? Are there royalties? Consider the traps in royalty provisions. Royalties are normally tied to “net sales.” There are a number of boilerplate exclusions, but there are also some conceptual issues, such as whether net sales are calculated on an accrual or cash basis. In sublicensing, do the royalties cover sales by all sublicensees, or just the payments received by the licensee and its affiliates. In many licenses, the licensor gets a large percentage of payments from a sublicensee that is not running royalties — for example, a fixed upfront payment or a milestone payment. If the licensor shares in non-running royalty payments, do those payments include equity in a joint venture?

• Define license transfers or sublicensing to third parties. What will be the impact on the licensee’s business if the license cannot be transferred in a merger, acquisition or asset sale? Normally a license is not transferable, but consider whether the license is automatically transferred on a sale of either party’s company. If not, non-transferability of an important license may be a significant impediment to the sale of the party’s business. Consider whether the other party has the power to restrict a transfer entirely or if the party is obligated to its reasonable judgment to deny a transfer. As a licensor, consider prohibiting the licensee from transferring or sublicensing to a competitor of the licensor.

• Can the license be terminated or re-

voked? Under what conditions can either party terminate or revoke the license? Other than abiding by the usage terms of the license, what notice or consent provisions must be adhered to in order to avoid losing the license or the licensee as a customer? Consider the circumstances under which the license can be terminated. A license is usually terminable for breach, but consider whether it should be terminable if the licensee does not achieve a specified milestone or substantially ceases use of the underlying technology, particularly if it is an exclusive license. If the license does get terminated, do sublicenses survive?

• If the licensor or the licensee makes improvements (including bug fixes and upgrades) to the technology, under what circumstances does the other party have rights to the improvements?

• Define how the licensor protects the licensee against infringement suits. In an exclusive license, who has the first right to defend, and how are the proceeds of a victory shared? Is there a limitation of liability if the licensor has breached a representation or warranty? Should there be a separate confidentiality provision? Do any of the license terms conflict with your other business contracts?

Remember that a license is just a contract, and as with reviewing or drafting any contract, the hard part is to make sure all of the important areas are covered. If you have answered all of these questions, you are on the right track to a successful licensing deal.

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