Licensing 101

1. What is a license?

A license grants permission to do something that is not allowed if the license is not granted. Stated differently, a license is a waiver of a right to sue for conduct that is actionable if the license is not granted.

The license is granted by the *licensor* to the *licensee*. The licensor retains ownership of the subject matter to which the license applies and, usually, receives compensation for granting the license. Some of the important characteristics of a license are:

- Whether the licensee's rights are restricted to a specified territory or may be exercised worldwide
- Whether the license is for a specified term or is of potentially infinite duration
- Whether the license is restricted to a certain industry or field of use
- Whether, and under which circumstances, the license may be revoked
- Whether the licensee may grant sublicenses of some or all of its rights to third parties (in which case the licensee becomes a *sublicensor* and the third parties become *sublicensees*)

2. What can be licensed?

The licensor can grant all or any subset of its rights in the subject matter, short of transferring ownership. The rights often are expressed in terms of intellectual property (IP) protection. For example:

- Copyright – the right to reproduce, prepare derivative works, prepare copies, perform publicly or display publicly (17 U.S.C. § 106)
- Patent – the right to exclude others from making, using, selling, offering for sale or importing the claimed invention (35 U.S.C. § 271)
- Trademark – the right to prevent others from using a confusingly similar mark (15 U.S.C. § 1114)
- Trade secret – the right to use information that derives value from not being generally known and is subject to reasonable efforts to maintain secrecy (*See, e.g.,* Uniform Trade Secrets Act § 1[4])

Sometimes the license grants rights that pertain to a product rather than its IP. For example, most software licenses grant the right to use the software (subject to certain limitations) rater than granting rights under any copyrights, patents or trade secrets that may apply to the software.

3. Why is licensing so widespread?

There are countless business reasons why it can make business sense to grant licenses. Here are some examples:

- So the licensor can receive revenue that reflects the amount of use by the licensee (such as when software is licensed on a per-user or per-computer basis)
- So the licensor can exercise control and maintain quality standards (such as when a franchisor licenses use of a name to a franchisee)
- So an IP owner can take advantage of the revenue-generating capability of a small number of industry leaders (such as when NTP forced Research in Motion to enter into a patent license and settlement agreement for $612.5 million)

- So multiple licensees can help a licensor gain market share quickly (such as when Microsoft licensed DOS and Windows to PC manufacturers while Apple restricted its operating systems to Macintosh computers)

4. How much does a license cost?

There are many different ways to set licensee fees. One of the simplest (mentioned above) is the prevalent per-user or per-computer fee for software licenses.

The pricing for patent licenses, on the other hand, tends to be more complicated, typically including variations on the following:

- A non-refundable up-front payment
- Recurring payments (often quarterly or annual) that server as advances against royalties or minimum royalty payments
- Royalties computed as a percentage of revenue that the licensee receives from sale of products that incorporate the licensed technology (See below, however, for a discussion of some of the problems that arise in trying to define revenue properly for royalty-calculation purposes.)

5. Can license terms be negotiated?

The general answer is "yes" – there is no "standard" license agreement. However, there are times when the licensor is in a position to dictate terms to the licensee so that negotiation is, effectively, impossible. For example:

- Software purchased at retail routinely comes with a "shrink-wrap" license on paper and on the software CD. In addition, the software may require acknowledgement of the license terms when the software is installed. The user is instructed to return the software for a refund if s/he does not agree with the license terms.
- Similarly, online services typically require that the user accept the terms of a "click-through" agreement, which includes license provisions, before using the service.
- Some companies either are so large or otherwise are so dominant in their fields that they can dictate terms on a "take it or leave it" basis to licensees.

6. Which license provisions tend to be the focus of negotiations?

The following provisions tend to receive the most attention, and require the most time, when license agreements are negotiated:

- What will be the scope of the license (industries covered, geographic restrictions, amount and type of use, right to grant sublicenses, etc.)?
- Will the license be exclusive or non-exclusive? (Exclusivity, if offered, usually costs much more.)
- What will the price be? (For revenue-based royalties, there can be lengthy discussions about how to handle components vs. finished products, discounts, taxes, transportation charges, returned or damaged goods, etc.)
- What will the licensor provide with respect to warranties and indemnification for third-party claims?
- What will the parties' respective limitations of liability and damages be?

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7. Are some provisions unique to patent licenses?

Yes. Aside from pricing considerations discussed above, the following are examples of unique issues that patent licenses raise:

- Third-party infringement – The licensee often will want the licensor to bring suit against any third-party infringer because the infringement reduces the value of the license. If the licensor does not want to take on this responsibility, it may give the licensee the right to sue the infringer. However, the licensee must be an exclusive licensee "with all substantial rights" to be able to exercise that right. *Fieldturf, Inc., et al. v. Southwest Recreational Industries, Inc.*, 357 F.3d 1266 (Fed. Cir., 2004)
- Patent expiration – If the underlying patents expire, a patent licensee need not make further license payments to the licensor. *Brulotte, et al. v. Thys Co.*, 379 U.S. 29 (1964); *Zila, Inc. v. Tinnell*, 502 F.3d 1014 (9th Cir. 2007) It, thus, can be in the licensor's interest to characterize the license as pertaining not just to one or more patents, but also to some other rights or products so payment obligations will continue even if the patents expire.

8. What are "open source" licenses?

"Open source" refers to software that is licensed on terms that give users the freedom to run, copy, distribute, study, change and improve the software. As changes and improvements are contributed back to the open source community, the software is enhanced to everyone's benefit. Open source is contrasted with proprietary software, the source code for which is under the licensor's tight control.

One of the best-known open source licenses is the GNU General Public License, usually referred to as the "GPL" (www.gnu.org/copyleft/gpl.html). An extensive list of open source licenses is available at www.opensource.org/licenses.

9. Which licenses are required to perform or record someone else's music?

No license is required to perform or record music that is in the public domain (i.e., that is not subject to copyright). This category includes, for example, classical music that was composed centuries ago.

For music that is subject to copyright in the U.S.:

- A license to perform the music publicly may be available from a licensing agency that represents the work – ASCAP (www.ascap.com), BMI (www.bmi.com), or SESAC (www.sesac.com).
- A "mechanical" license to record the music can be obtained, subject to certain conditions, from the Harry Fox Agency (www.harryfox.com) under the compulsory license provisions of 17 USC § 115.

10. Are there special rules where the U.S. government is the licensee?

Yes. The U.S. government does not license rights under patents or copyrights. Instead, it acquires rights under its eminent domain powers and pays reasonable compensation to the patent or copyright holder. The starting point is to file a claim with the applicable government department in accordance with the applicable provisions set forth in the Code of Federal Regulations.

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11. What should I look out for in international license agreements?

International considerations tend to make negotiation of choice-of-law and jurisdictional provisions both more important and more contentious. You might want to consider a neutral dispute-resolution venue, such as the World Intellectual Property Organization or the International Chamber of Commerce.

The United Nations Convention on Contracts for the International Sale of Goods is, roughly, the international equivalent of the Uniform Commercial Code. Parties to international license agreements often expressly exclude the Convention (which is allowed by its Article 6), because they want their negotiated terms, rather than general terms designed for international shipment of tangible goods, to govern the license.

Moral rights are the rights of a creator to control the fate of his or her work, thus protecting the personal and reputational value of the work. These may include the right to receive or decline credit, prevent alteration, control ownership, or dictate whether or how the work is displayed. Whereas in the U.S. moral rights apply primarily to visual art under the Visual Artists Rights Act of 1990 (17 U.S.C. § 106A), in many other countries moral rights apply much more broadly. Because moral rights are personal, they cannot be assigned, but they can be waived. As a result, a licensee who requires licensor representations about ownership of the licensed subject matter should ensure that moral rights are addressed appropriately.

12. How can I protect my company if I am concerned about the financial viability of the other party to a license agreement?

First, you may be able to perfect your license rights, to establish priority over certain third parties, by recording the license agreement in two ways:

- State – Section 9-505 of the Uniform Commercial Code allows licensors to file financing statements, using the terms "licensor" and "licensee" rather than "secured party" and "debtor".
- Federal – Patent licenses can be recorded online under the Electronic Patent Assignment System (epas.uspto.gov), and trademark licenses can be recorded online under the Electronic Trademark Assignment System (etas.uspto.gov). There is no online recordation of copyright licenses; information about manual recordation is available at www.copyright.gov/document.html.

Second, the following protections are available to licensees:

- In bankruptcy, if the debtor/licensor rejects an executory license, Bankruptcy Code § 365(n) allows the licensee to (a) treat the license as terminated and assert damages for breach or (b) retain its rights under the license. (This does not apply to trademark or service mark licenses.)
- An object-code software licensee may be able to persuade the licensor to put source code into an escrow for the licensee's benefit if the licensor goes out of business or otherwise fails to support the software adequately.

The information in this document is not intended as legal advice. If you need legal advice on a matter, please contact an attorney directly.

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