7 Licensing and related transactions

Licensing is the vehicle by which the IP rubber meets the commercial road, with someone else doing the driving. The idea of allowing others, even competitors, access to hard-won proprietary rights may have seemed absurd a generation ago, but today it is commonplace and a huge source of IP-driven revenue. To be sure, licensing is by no means the only way to realize value from IP; many patents thrive locked away in a safe, securing the realm against marauding technology thieves and increasing (sometimes largely constituting) a firm's asset value. But, as soon as a company or institution finds it attractive to look beyond its own capacity to monetize technology, licensing becomes inevitable.

A license is essentially a promise not to sue. You are given permission to infringe someone's IP without fear of legal repercussion. A ticket to a concert is also a license – permission to enter and listen without being thrown out unless you make too much of a pest of yourself (that is, violate the terms of the license). Unlike a concert ticket, however, an IP license is *personal.* Concert promoters do not care if you give your ticket to someone else. An IP owner, by contrast, does not want valuable rights falling into the wrong hands – those of her competitor, for example, or hands simply less capable of effectively exploiting the IP (for the ultimate benefit of its owner). Most license arrangements reflect a balance between the licensee's need for enough rights and incentives to justify the market risk of product introduction, and the licensor's aversion to tying up or losing control over its innovations.

Basic terminology

Owners have broad latitude to carve up the IP turkey as they see fit – dictating when, where, and to what extent a licensee is free to exploit the rights it receives. An ***exclusive*** license empowers the licensee and no one else; even the licensor cannot make use of what it has granted. If the licensor wishes to reserve the prerogative to make and sell the technology and compete with the licensee in the marketplace, it grants a ***sole*** or ***co-exclusive*** license rather than an exclusive one.[1] Because an exclusive license cedes so much control to the licensee, it may be treated as a complete transfer of ownership for tax and other purposes. An exclusive licensor, fearful of entrusting its proprietary rights to a frog disguised as a prince who will botch their exploitation or forget about them entirely, typically insists on various performance measures and rights of termination.

A ***nonexclusive*** license, by contrast, can be granted to numerous takers on the same or varying terms. A nonexclusive license may seem easy to grant, since it does not preclude other such licenses. But it does eliminate the possibility of granting *exclusive* rights to anyone. A nonexclusive license commits the licensor to a one-to-many rather than a one-to-one strategy. If the licensor has second thoughts (or believes, incorrectly, that the nonexclusive license has expired) and tries to grant an exclusive license notwithstanding the earlier commitment, the licensee is out of luck – even if it did not know about the prior license – because a licensor can grant no more than it owns. Licenses are typically confidential, so any prospective licensee must assure itself it is receiving what it bargained for.

A license may be ***royalty-bearing*** or ***paid-up***. Software publishers, for example, grant paid-up non-exclusive licenses to their customers, because in purchasing the software they have, in fact, paid up. But money need not change hands for a license to be paid-up. A ***cross-license*** allows two patent owners each to make use of the other's patents, often without any form of balancing payment. Litigation settlements, for example, often include cross-licenses. Paid-up licenses are often ***irrevocable*** – no matter what the licensee does, the license is hers forever – and ***perpetual***.

A ***grantback*** may also be couched in the form of a paid-up license, either exclusive or nonexclusive. A grantback provides the licensor with rights in any improvements or modifications that the licensee makes to the licensed technology. That may seem rapacious on the part of the licensor, but, in fact, grantbacks enjoy a long tradition and reflect the licensor's legitimate aversion to being walled off from its own technology. If a licensee figures out a way to make the licensed subject matter faster, better, or cheaper, it has done so only because the licensor has given it access in the first place; without a grantback, many licenses would never be signed, so great is the fear of being leapfrogged.

The terms of a grantback may vary in terms of exclusivity both with respect to the licensor and the licensee: the licensor may seek an exclusive grantback, preventing the licensee from allowing others to use its improvements, while

[1] This is United States terminology. In other countries, an "exclusive" license may correspond to what Americans call a sole license.

the licensee may seek restrictions that prevent the *licensor* from re-licensing the grantback to others. United States law tolerates nonexclusive and (to a lesser extent) exclusive grantbacks, as well as outright assignments of improvements, so long as the effect is not anticompetitive. As we will soon see, other countries draw the line at the nonexclusive variety.

Rights may be worldwide or limited to a defined territory, of indefinite ("perpetual") duration or restricted to a fixed term, unlimited in scope or confined to a specified field. As explained in chapter 3, field limitations allow the licensor to have different companies pursue different applications of its technology, and those applications may be segmented – by industry (or, more finely, within an industry), by market, by customer identity or type, according to the type of equipment to be sold or the use to which it is put, therapy v. diagnostics, medical v. veterinary – in any way that makes business sense, so long as the licensor can find different licensees willing to coexist.

Because licenses are personal, they cannot be ***sublicensed***, allowing the licensee to delegate the granted rights to someone else (either in lieu of or in addition to itself), without the consent of the licensor.

Basic terms

The most important terms of a license specify the nature and duration of the licensed rights, how the licensor will be paid, and the conditions under which either side can extricate itself from a deal gone sour. Exclusive licenses focus heavily on the latter issues, and also specify the efforts the licensee must make to bring the technology to market. It is often wise to obtain a common understanding of these basic underpinnings by way of a term sheet before drafting the full agreement.

The layers of complexity built on this foundation reflect planning for contingencies and the unexpected, the need to preclude funny business (such as arbitrage), and an exchange of assurances that each side means what it says.

CASE STUDY #5: Let's return to our friends at RSS, who, you may recall from chapter 3, have decided to license their sequencing technique to a large manufacturer of biotechnology. They have struck a deal with GeneMachine, Inc. What basic provisions will they need? What concerns motivate each side? And how might they approach negotiation?

The grant defines the character, scope, duration, and territorial extent of the license. The typical grant allows the licensee to commercially exploit, in any way it chooses, all technology falling within the license. But there is no magic in this formulation; the licensor is free to divide those rights among different