Licensing Issues In Theory And Practice:

Four Lessons Learned Handling Licenses

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Four Lessons Learned Handling Licenses

1. A license always entails some risk to the licensee’s freedom to operate.
2. Complex license structures invite misunderstanding between the licensor and the licensee.
3. Business people and lawyers may have different interests and attitudes towards structuring and concluding agreements.
4. When negotiating with the aggressive licensor, understand both sides’ cost/benefit considerations.

1. A license always entails some risk to the licensee's freedom to operate

- This is because the licensee does not have complete control over the intellectual property it needs to operate its business.
- If circumstances change and you need to re-negotiate the license terms, the licensor usually has the upper hand.
- Example: Licensee needs expanded fields of use, rights to sublicense, rights to ancillary IP.
  - The amendment generally benefits the licensee more than the licensor, so the licensor can exact a "transaction cost" to amend the license.

1. A license always entails some risk to the licensee's freedom to operate (cont'd)

- If serious misunderstandings arise, the licensor may send a notice terminating the license, causing enormous problems for the licensee.
- Example: Ciphergen v. MAS.
  - Different understandings about the scope of the MAS licenses to Ciphergen resulted in significant market confusion and a lawsuit lasing over three years.

2. Complex license structures invite misunderstanding between the licensor and licensee

- A good rule of thumb – In addition to the usual grant language, one should, for clarity:
  - Specifically allow, without limitation, the activities you know you want the licensee to do.
  - Specifically disallow, as a limitation, the activities you know you do not want the licensee to do.

Start with the basic patent license grant:

- *Licensor grants licensee a license to make, use, sell, offer for sale and import any invention covered by the patent.*
  - This grant gives the licensee the right to infringe any claim in the patent with impunity.
  - Limitations on activity generally will not be implied.

First complication – Limitations based on inventions:

- *Licensor grants licensee a license to make, use, sell, offer for sale and import <u>any Licensed Product</u>.*
- Need to define whether “Licensed Products” include:
    - “Things,” i.e., machines, articles of manufacture and compositions of matter, and
    - “Methods,” i.e., processes

Second complication – Intellectual property beyond the patent:

- *Licensor grants licensee a license to make, use, sell, offer for sale and import any Licensed Product <u>and to otherwise exploit the Licensed Technology</u>.*
  - The license may be meant to cover not only patents, but associated technical information, such as trade secrets, not strictly covered by the patent.
  - Contract law may place different exclusive powers on such IP.

Third complication – Field of use restrictions:

- *Licensor grants licensee a license to make, use, sell, offer for sale and import any Licensed Product and to otherwise exploit the technology in the Field Of Use.*
- “Fields Of Use” can be limited by:
  - Customers
  - Place of use
  - Activities
- Each can introduce ambiguity

Fourth complication – Parsing The Grant Language:

- *Licensor grants licensee a license to make and use but not to sell Licensed Products.*
- *Licensor grants licensee a license to make and sell but not to use Licensed Products.*

- What is the difference between “using” in the Field Of Use” and “selling” into the Field Of Use?

Solution: If the grant includes any kinds of limitations, specify allowed or prohibited activities that may be ambiguous

- *Licensor grants licensee a license … including, without limitation, the right to both sell the product to customers and use the product to sell services to customers.*
- *Licensor grants licensee a license … except that licensee may only use the product that it makes for its own use and may not sell product to customers.*
  - Such statements reduce ambiguity and the chance of misunderstanding.
- The good litigator will use any ambiguity as a wedge to move the solution toward what the client wants.

3. Business people and lawyers may have different interests and attitudes towards structuring and concluding agreements

- Lawyers' interest: A clear document that has every conceivable contingency covered.
- Business persons' interest: Concluding a deal having an acceptable level of risk within a time frame limited by market pressures.
- As a lawyer, your job is to make sure the business people understand the risks that they cannot eliminate.

4. When negotiating with the aggressive licensor, recognize both sides' cost/benefit analysis

- Situation: Your Company is approached with an offer of license by a desirous licensor asserting that its patent covers certain of your products or activities.

Some basic concerns:

- Does the licensor actually have the undisputed right to grant licenses under the patent?
- What does the licensor believe is the scope of the claims?
  - The licensor may have a surprisingly different interpretation of the claims than you.
- What does the licensor want as compensation for the license, and how did the licensor arrive at this amount?
  - What is a reasonable royalty and the royalty base?

To Determine The Amount Of Settlement, Perform A Cost-benefit Analysis:

- The ultimate choice is between
  - accepting an agreed-upon settlement amount
  - having a lawsuit

Cost/Benefit Of A Lawsuit

- The licensor's expected return on a lawsuit is, roughly:
  - (expected damages) – (legal fees) = Expected return
  - E.g., $3,500,000 (expected damages) - $3,000,000 (legal fees) = $500,000 (expected return)
  - Factor-in other mitigating/augmenting factors such as finding of non-infringement, loss of patent, countersuit, willfulness and precedent.
- The target's expected cost of a lawsuit is, roughly:
  - (expected damages) + (legal fees) = Expected cost
  - E.g., $3,500,000 (expected damages) + $3,000,000 (legal fees) = $6,500,000 (expected cost)
  - Factor-in other mitigating/augmenting factors such as finding of non-infringement and willfulness.

Logic of the negotiation range:

- If target offers more than $500,000 then licensor should not sue
  - Because the expected return on suit is less than the amount offered.
- If licensor requests no more than $6,500,000 then target should accept settlement
  - Because the cost of settlement is less than the cost of a lawsuit.
- Negotiation range is $500,000 to $6,500,000!

Settling on a number:

- Target can hold out until the offer approaches the lower end of the range -- $500,000.
- Any lawsuit by the licensor to compel the target toward the high end of the range would amount to a “spite” lawsuit – causing damage to both parties just to inflict more damage on the target.
  - Spite lawsuits are not, rationally, in a party’s best interest.
  - Do not always expect your opponent to act rationally – you are dealing with emotional human beings.

The Licensor Should:

- Initially ask for an amount near the high end of the range.
  - Ask for a large royalty on a large royalty base.
- Try to force the target to make mistakes and bid against itself.
  - Make the target go first in suggesting:
    - Scope of claims
    - Reasonable royalty
    - Their own activities
  - If you don't like an offer, ask target to offer a better one
    - Rather than making a counter-offer
- Make the negotiation process, itself, expensive for the target.
- Hope the target prefers settlement to suit.

The Target Should:

- Determine a reasonable claim scope.
- Calculate a reasonable royalty for the technology.
- Apply it to the royalty base as per the claim scope.
- Offer an amount between this and the licensor’s expected return on a lawsuit.
- Stick to its guns, and hang on!

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