

Guide to licensing intellectual property



This information sheet is a brief guide to the licensing of intellectual property (IP) rights. It summarises what you need to consider if you are preparing or negotiating an IP licence

Why license

In many cases, the owner of an IP right may not be the person best placed to commercially exploit it. Often the owner lacks the necessary skill, capital or commitment. A common solution is for the IP owner to find someone who does have these things, and grant a licence to that person.

IP licensing is also common in joint venture arrangements and in the settlement of disputes.

IP licences take many forms, depending on whether the IP involves patent rights, design rights, copyright, trade marks, know-how, or a combination of these things. IP licences also include franchise agreements and software licences.

A well-drafted licence will include a number of key terms. These are described in more detail below.

Scope of the licence

The provisions of the licence that outline the scope of the rights granted are critical. The licence should:

- include clear definitions to make it clear what IP rights are licensed. A badly drafted IP rights definition may leave uncertainty about what rights the licensee actually has;
- state whether the licence is exclusive or non-exclusive. A non-exclusive licence allows the IP owner to grant the same rights to another person. An exclusive licence means only the licensee may exercise the rights granted;
- state the territory in which the licence is granted;

- state any other restrictions on the rights of the licensee to exploit the IP, such as field of use limitations;
- state whether the licensee may grant sub-licences or transfer its rights to others and, if so, on what terms.

Technology transfer and handover

The licensee will often need the IP owner's support and know-how about the IP being licensed. So most technology licences will make provision for an initial handover or support period.

The support provided may take the form of labour, materials or prototypes. The support may be limited to the start-up period, or it may be ongoing.

It is critical to define carefully in the licence the scope of any support to be provided, and who is to pay for it.

Quality control

The IP owner will usually want to retain some control over the quality of the goods or services supplied by the licensee under the licence.

Retaining control is especially important where the conduct of the licensee has the potential to negatively affect the brand or reputation of the IP owner.

Typical control provisions include:

- giving the IP owner the right to inspect the premises or manufacturing facilities of the licensee;
- requiring the licensee to make the product or provide the service to an approved standard or specification;
- requiring the licensee to provide samples of the licensed product;

- obliging the licensee to report to the IP owner in the event of a complaint or issue with a licensed product or service.

Payment terms

- Most licence payment terms involve one or more of the following:
- an up-front fee;
- ongoing lump sum fees;
- ongoing royalty payments.

Royalties are often based on a percentage of the licensee's net sales or revenues from exploiting the IP. But in some cases the royalty will be a price per unit of product sold. If the IP relates to a service or process, each instance of that service or process being performed may attract a royalty payment.

If the licensee is to pay a royalty, the following terms should be included in the licence:

- detailed reporting and auditing provisions, so the IP owner can track what it is owed;
- provisions dealing with non-resident withholding taxes, if the licensee is not based in the same country as you;
- if royalties are based on a percentage of the licensee's net sales, provisions that ensure if the licensee makes a sale for less than the true market value, the royalty is based on the true market value of the transaction.

If you want more information about royalties and licence fees, please ask your contact at AJ Park for a copy of our Guide to Royalties and Licence Fees.

Performance

It is common for an exclusive licence to include minimum performance obligations on the part of the licensee. These might include the obligation to achieve a minimum number of sales, or to pay a minimum royalty.

If the licence covers a number of different products, territories or markets, the IP owner might consider imposing a separate performance obligation for each product, market or territory.

The licence needs to clearly state what happens if any minimum performance obligations are not met. The consequences could include one or more of the following:

- the licensee being required to pay a top up payment;
- the exclusive rights granted to the licensee becoming non-exclusive;
- partial termination of the rights granted;
- full termination of the licence.

IP protection, enforcement and defence

The licence should set out who is responsible for securing, maintaining, defending and enforcing the IP rights being licensed.

Some of the issues the licence should address are:

- if the IP rights include applications, who is responsible for securing full registrations, and in which countries will protection be sought?
- who will pay any IP protection costs?
- how will the parties to the licence handle any third party claim of IP infringement?
- how will IP infringements by third parties be dealt with?
- in any IP infringement matter, who will bear the costs of taking or defending any action, and who will be entitled to any costs or damages awarded?

These provisions need to be carefully drafted. A badly drafted IP enforcement or infringement clause can prove very costly.

Liability issues

A well-drafted IP licence will include detailed liability provisions. It is common to include provisions excluding or limiting liability for certain types of losses. These may seem like routine clauses, but they can significantly affect the remedies of the IP owner if the licensee is in breach.

The licensee will often seek warranties from the IP owner about the IP the subject of the licence. But the IP owner should resist giving any of the following warranties:

- that an application for any IP right will result in a granted registration;
- that any IP right is or will remain valid; or
- that the use or exploitation of a product or service the subject of the IP rights will not infringe someone else's IP rights.

In the IP owner's ideal world, the IP owner will put the onus on the licensee to undertake its own due diligence on the IP rights being licensed. If that is not possible, the IP owner should limit its warranties only to those things that are within its knowledge. For example, rather than warranting that there are no third party infringers, the IP owner may be prepared to warrant that it is not aware of any third party infringers.

The IP owner should ensure the licence includes an indemnity to protect the IP owner from product liability claims. In some countries the IP owner may be liable for defective products supplied by the licensee. An indemnity from the licensee will provide a remedy for the IP owner in the event it suffers a loss in such circumstances.

Term and termination

The licence needs to state clearly what the period of the licence is, and in what circumstances it may be terminated.

The licence should also provide for early termination in the event of a breach by, or the insolvency of, a party, or in the event the licensee challenges the IP rights being licensed.

The licence should also include provisions setting out what the consequences of termination are. These might include:

- whether the licensee is able to continue to sell any remaining stock;
- whether remaining stock must be sold to the IP owner, and if so at what price;
- provisions dealing with the destruction or return of confidential information;
- provisions outlining to what extent sub-licences continue in force;
- provisions dealing with the transfer to the IP owner of any relevant consents or permits held by the licensee.

Other essential provisions

- The licence should include confidentiality provisions to protect the information of the parties and the commercial terms of the contract.
- The licence should state clearly which country's law governs the contract and how disputes are to be determined. It is common for licences to include mediation or arbitration provisions.
- The licence should address who will own any improvements to the product or service the subject of the licence, and who may exploit those improvements.

Our expertise

At AJ Park, we have expertise in all types of IP licensing; we can help you negotiate a licence that protects you and your IP.

For advice on IP licensing, contact AJ Park's commercial team.