Licensing Basics
for Technology and Life Sciences Companies
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# Licensing Basics for Technology and Life Sciences Companies

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Introduction

Virtually all technology and life sciences companies rely on licensing to achieve their business goals. Some companies license special manufacturing techniques from third parties to more efficiently make the products that they develop and sell. Other companies rely on licensing for partnering with other entities to share the risks and rewards of research and development of drug products, a process that necessarily involves a long and uncertain regulatory approval timeline. Still other companies regularly cross-license their patents and other intellectual property with competitors to avoid expensive and distracting litigation.

Because licensing plays a critical role in the operations of technology and life sciences companies, it is important for corporate decision makers to understand the basic mechanics of licensing and the strategies implemented through license agreements. Toward that end, this booklet provides a primer on licensing in general, with a focus, where appropriate, on licensing basics and related issues of interest to technology and life sciences companies.
What Is a License?

A license is a contract between a “licensor” and a “licensee” that allows the licensee to make some specified use of the licensor’s property. Typically, the licensor’s property would not otherwise be available for use by the licensee, either because it is a trade secret not known to the licensee or because there is some legal restriction, such as a copyright or patent, that prevents the licensee from using the property.

A license differs from a sale in that ownership of the property is not transferred and the licensor retains certain rights to the property. However, in some instances, a license can grant sufficiently broad rights that the law considers the transaction tantamount to a sale. The ramifications of characterizing a transaction as a license or a sale may be particularly significant in the tax area, where the treatment of the payment (i.e., whether it is capital) and the timing of its recognition, as well as issues of deductibility and withholding taxes, may differ drastically depending upon how the transaction is characterized. It is not always easy to tell whether a particular transaction will be considered a sale or a license for any particular legal purpose.

Under traditional property law concepts, property rights are thought of as a bundle of individual rights, such as various rights to exclude others from the property and other rights to exploit the property as the owner sees fit. Licenses are the legal tools used to allow others to enjoy at least some of those individual rights, for at least a limited period of time, or under at least a limited set of circumstances.

Types of Licenses
The different types of licenses used by technology and life sciences companies are limited only by human imagination. Some common considerations apply to all licenses, while other issues arise only in particular types of licenses. In order to discuss such considerations, it is important to be able to distinguish among various types of licenses.

Nonexclusive Licenses
The most common type of license is a nonexclusive license. A license is nonexclusive if the rights granted to the licensee may also be granted to others. For instance, a typical license to use a commercial software product is nonexclusive, because there are numerous other licensees for that product.

Exclusive Licenses
A license is exclusive when the licensee is the only entity that is granted the licensed rights. For instance, the owner of a fast food franchise may be granted the exclusive right to use franchise trademarks within some specified geographical area. In some instances, exclusive licenses may be so broad as to be virtually indistinguishable from outright transfers of
ownership. For example, some software houses will grant an exclusive license to a distributor to reproduce, distribute and sublicense a computer program. The license grant in such a case is often exclusive even against the software house that wrote the program. The owner may retain very little, if any, of the original bundle of rights associated with the licensed property.

Product Licenses
The subject matter of some licenses is described in terms of particular products. For instance, the developer of a particular circuit may license some company to manufacture and sell the product. The parties to a product license generally need not specify which of the individual legal rights held by the licensor are granted to the licensee. Instead, the licensor grants any and all legal rights that it has relating to the specified exploitation of the licensed product. Indeed, some product licenses may not be a legal prerequisite for the licensee to exploit the product as specified in the license. For instance, if the license is for rights to manufacture a conventional office chair, the licensor might not have had any right to seek redress had the licensee manufactured such a chair without any license at all. Presumably, knowledgeable parties would not place much value on such a license. More often, however, the parties are unsure of the extent to which the licensor might be able to assert rights against a product or process that the licensee wants to make, use or sell, so for simplicity’s sake a product license is used. For instance, a typical end-user software license grants to the user whatever rights of the licensor may be required to allow the user to run the software in the manner specified in the license.

Patent Licenses
Patents are government grants to inventors for new, useful and unobvious processes, machines and compositions of matter (i.e., utility patents), and for new, ornamental and unobvious designs of manufactured articles (i.e., design patents). The owner of a patent is given the legal right to exclude the unauthorized use, manufacture, sale, offer for sale or importation of products or services that include the patented subject matter.

One principal motivation for inventors to seek patents is the prospect of revenue that can be generated from licensing such patents to others. Thus, the owner of a patented manufacturing process can negotiate patent licenses with numerous manufacturers who would find it advantageous to use such a process. It should be noted that a manufacturer might have to obtain patent licenses from several different patent owners if the product or the process of manufacturing it incorporates the subject matter claimed by each of several patents.

Copyright Licenses
A copyright provides its owner with a number of exclusive rights pertaining to a work of authorship, including rights of reproduction and distribution. A significant limitation of copyright protection is that it extends only to the expression present in a work of authorship,
not the underlying ideas, concepts or systems. Nonetheless, copyright is a valuable and popular tool for the protection of such technology as computer programs.

Some copyright licenses permit the work to be modified, while others do not. In copyright terms, a new work that includes a licensed work or that modifies a licensed work is known as a "derivative work." If a licensee wants to make changes to a work provided under a copyright license or wants to embed that work into another creative work, the licensee should be sure that the license extends to the creation and marketing of such derivative works.

Trademark Licenses
A trademark is a word, symbol or other distinctive attribute associated with a product or service that indicates to the marketplace the origin of the product or service and distinguishes it from those of others. Product names, company names, logos and even colors and fragrances may be trademarks. The purpose of a trademark is to provide the marketplace with a means of keeping track of the source or origin of various products and services. In that sense, trademarks protect the goodwill developed by the originating companies that manufacture or supply goods or services bearing the associated trademark.

Because of the underlying function of trademarks, trademark licenses usually are accompanied by other restrictions on the licensee. If the only right granted by a license is the right to use the mark, the mark will no longer bear any relation either to a particular source of goods or services, or to any corresponding reputation. Therefore, trademark licenses generally include provisions that require the licensee to meet certain standards, such as quality. Trademark licenses also generally provide the licensor with a measure of control over the licensee to ensure that not only the licensor's trademark, but also the licensor's goodwill represented by the trademark are carried over by the licensee.

Trade Secret Licenses
A trade secret is any information that provides value to its owner by not being generally known to others and which is the subject of reasonable efforts by the owner to maintain the confidentiality of the information. Trade secrets can include not only technical information such as formulas, computer program code and manufacturing processes, but also business information such as customer lists. Trade secret rights can exist indefinitely, but are extinguished if the information is publicly disclosed, and are diminished and no longer the exclusive property of the original owner to the extent that the trade secret information can be re-created or laudably obtained (e.g., by reverse engineering).

It may be counterintuitive to imagine that trade secrets can be licensed, because a license of a trade secret by definition discloses the secret to another. However, the law permits licensing of a trade secret as long as the licensee is obligated to protect the confidentiality of
the secret vis-à-vis third parties. Licenses of trade secrets are used extensively among high-technology companies, particularly where the companies have a vertical relationship, e.g., where the licensee manufactures products to the confidential specifications of the licensor.

In some instances, information that is not strictly a trade secret is licensed as “know-how.” The legal protection afforded a licensor of such information is unclear. In some instances, unauthorized use of know-how may be actionable as a breach of contract or unfair competition. In other instances, if the know-how is not protected by trade secret law (or by patent, copyright or trademark law), the licensor may not have a cognizable property right to assert against an infringer.

**Joint Development Licenses**

It is common for one technology-based company to enter a joint development agreement with another in order to collaborate in development of a product calling for the special resources of each company. Often, each company will need to use some of the technology of the other in the course of such development. A joint development license permits such limited use of each company’s technology. When development of the new product is completed, the joint development license grants each party whatever rights may be required to market the product. Cost sharing arrangements, under which participants are joint owners of the property they develop, may eliminate the need for cross-licenses in some situations.

**Cross Licenses**

A cross license agreement is essentially two licenses combined into one agreement and is used when each party to the agreement wants to obtain certain rights to the other party’s property. Cross licenses often arise as the result of patent disputes, which have the potential to significantly disrupt the business operations of all involved parties. For example, if company A asserts its patent against company B, company B may respond by asserting its own patent against company A. Rather than engaging in litigation to determine a victor in such a dispute, company A and company B may simply decide to cross license each other’s patents. In some situations, no monetary payment is involved. Often, such companies cross license not only the patents in dispute, but also numerous others, up to and including the entire patent portfolio of each company.

**Conditional Licenses**

Contracting parties sometimes agree that if one party fails to do something, a license is created. For example, if a software vendor fails to deliver sufficient quantities of its products to a distributor, the distributor may be granted a license to reproduce such products from master copies for the limited purpose of satisfying legitimate orders. Another instance where a conditional license may be granted is when a vendor fails to provide maintenance services such as bug fixes, as provided in an end-user agreement. The agreement may provide that the end user is conditionally granted a license to make derivative works of the product as necessary to fix such bugs.
Licensor Considerations

The considerations motivating licensors and licensees are often quite different, and are separately discussed. Of course, an issue of interest to a licensor will of necessity become of interest to the licensee during negotiations.

Revenue

Revenue is generally the prime motivator for most licensors. Typically, a licensor has expended a great deal of time and money to develop a valuable technology, and a license is a common tool by which the licensor can exploit the value in that technology. License revenue is typically sought either through upfront license fees, periodic fees or both. The term “royalty” is commonly used to refer to periodic fees that are due and payable upon dispensing a product or service including the licensed technology. Depending upon the expectations of the parties, royalties may be negotiated to be paid on a volume basis, e.g., $10 per unit sold; on a temporal basis, e.g., $10,000 per year; or on a value basis, e.g., 2 percent of net selling price. Numerous variations for establishing revenue are used in technology licenses. Examples include up-front payment with yearly “maintenance” fees or minimum annual fees; tiered royalties based upon volume or gross revenue thresholds; minimum and maximum payments; and optional payments for maintaining exclusivity. No matter what mechanism is used for determining the revenue generated by a license, a licensor’s interest in maximizing the revenue and a licensee’s concomitant interest in minimizing the license cost are generally the most fundamental issues underlying license negotiations.

Limiting Competition

Technology often is licensed rather than sold in order for the owner to retain greater control than would otherwise be possible. Because a license is an ongoing agreement between two parties, it is common to include in a license restrictive terms that protect the licensor’s property rights. For instance, many software licenses call upon the licensee to maintain the licensed software in confidence and not disclose the software to third parties. This limits the ability of competitors to study the licensor’s product. Another typical restriction in software licenses prohibits the licensee from using the software for anything other than its own internal purposes. Thus, the market for the product is not reduced through the licensee’s acting as a competitor by offering the benefit of the software to third parties.

Not only is it traditionally difficult to negotiate such terms in a sale agreement, but in some instances the law would frustrate such attempts as well. For example, copyright law has a “first sale doctrine” that limits the control of a copyright owner with respect to a particular copy of a work once ownership of the copy is transferred. If an artist sells a sculpture to a homeowner, expecting the sculpture to be exhibited in a private home, the artist may
have no recourse if the homeowner sells the sculpture to the owner of an office building for display in the lobby of the building.

**Market Share**

Licensors who are primarily motivated by revenue considerations are likely focused on long-term revenue generation. Maximization of long-term revenue generally involves building up a significant market share. Thus, many licensors are amenable to terms ostensibly favorable to licensees in order to establish market share. In the software industry, inexpensive upgrades, either from earlier versions or from competitors’ products, exemplify such tactics. Other manifestations of licensors’ desire for market share are: licenses that extend to single-user operation on an office computer, a laptop computer and a home computer; user-friendly, plain English licenses; site licenses providing reduced rates for multiple users; free licenses for viewer programs to permit end-user access to files created by a corresponding licensed product; and, most notably, introduction of new products through shareware licenses providing for a free trial period or seeking only a recommended payment, and with no apparent means of enforcement.

In other portions of the technology and life sciences industries, patent licenses are often provided on a free or nominal payment basis in order to promulgate the patented technology as a *de facto* industry standard.

A related consideration impacting many patent licensors is the importance of “charter” licensees, *i.e.*, the first licensees of a new patent. Oftentimes, new patents are viewed with skepticism by the industry, particularly where there is some question as to the scope of the patent or whether it would be upheld as valid and enforceable by a court. Among the acknowledged secondary indicia courts look to in determining the validity of a challenged patent are the commercial success of the patented invention, and industry acquiescence in the patentee’s claim of proprietary rights to the invention. Therefore, patentees often provide very favorable terms to early licensees to imbue the patent with industry recognition, reputation and respect in order to help forestall possible future attack on the validity or enforceability of the patent.

**Licensee Considerations**

The factors motivating licensees are often quite different from those of greatest concern to licensors. Some of the more common licensee considerations are discussed below.

**The Technology**

The most obvious reason motivating licensees to enter into a license agreement is to obtain rights to use the licensed technology. However, licensees have a variety of reasons
for wanting the technology. Some seek to fill gaps in their own research and development programs with an immediately available solution. Others are simply in the business of marketing licensed technology. Whatever their reasons for wanting the technology, most licensees focus their attention in negotiations on ensuring that they will receive sufficient rights to enjoy the technology in the manner that they desire.

A common cause of breakdown in licensing negotiations is an inability of the licensor and the licensee to agree on the scope of the license grant. In other words, the licensee is seeking greater rights and lower cost than the licensor is prepared to provide or accept. Accordingly, it is of paramount importance that the parties discuss, at an early stage of negotiations, the nature of the rights that the licensee wants and that the licensor is willing to provide.

**Resolution of Disputes**

It is quite common for a license to be the tool by which a dispute between two parties is resolved. When this is the case, the licensee wants to ensure that the license effectively serves this purpose.

For example, if company A's product has been accused of infringing company B's patent, the companies may agree to resolve the issue through a license. In negotiating the license, company A wants to be sure that its product, as well as anticipated future versions, will be immune from future charges that such products infringe the patent. Company A also wants to ensure that no similar issues arise with other patents owned by company B.

**“Peace of Mind” and Options**

Some companies obtain licenses to technology or specific patents that they are not currently using, just for the peace of mind of knowing that if it becomes desirable to use such technology or patents in the future, they will have the right to do so. This strategy is typically adopted by larger companies with the resources and the breadth of development activities required to justify the cost for such licenses.

Smaller companies may be forced to adopt a similar approach, particularly where their customers demand such protection. There are a number of well-documented examples of publicity surrounding “notorious” patents leading to market pressure that is sufficiently strong to compel distributors or vendors to take licenses under such patents, despite substantial doubts about the merit of the patent or the need for any license under it.

Companies occasionally engage in option agreements when substantial doubts exist about the commercial significance of a technology, or about the strength or scope of associated patent rights, and the like. In these circumstances, a prospective licensee may negotiate for an option (a current agreement with separate supporting consideration) to acquire an exclusive or nonexclusive license to the technology and associated intellectual property rights prior to a specified future deadline date, for specified price and terms, upon exercise.
of the option (usually at the election of the prospective licensee). Such option transactions may be used to “lock up” a technology and associated rights until uncertainties can be resolved, investigations can be completed and the option grantee can decide whether to exercise the option to acquire the specified license.

“Quiet Enjoyment”
Licensees, having paid for the right to use licensed technology, generally seek to ensure that nothing interferes with the benefits they have received. For example, licensees are concerned with their ability to obtain assistance from the licensor in fixing defects that are discovered in the technology, to have the right to fix the defects themselves if the licensor is unable to do so, to obtain periodic upgrades and other maintenance services from the licensor, to transfer their rights if they sell their business and to continue enjoying the technology even if the licensor becomes bankrupt.

Licensor and Licensee Restrictions

While United States law generally leaves licensors and licensees unfettered in drafting agreements as they see fit, the law does impose some limitations. These limitations primarily prevent licensors from imposing terms in license agreements that are thought to be contrary to public policy. For example, antitrust laws prevent licensors from requiring licensees to purchase staple articles of commerce as a condition to obtaining a license to patented technology. The motivation for such restriction is to prevent the licensor from unduly expanding the market power conferred by the patent grant to effectively also control unattended goods. Similarly, the doctrine of patent misuse is applied in certain situations where a licensor imposes license fees that do not change as patents for the licensed technology expire.

Sometimes a licensor attempts to impose restrictions on a licensee (or vice versa) that are not enforceable, again due to public policy considerations. For example, the Supreme Court has held that a license provision attempting to prevent a licensee from challenging the validity of a licensed patent is not enforceable, as licensees are generally in the best position to learn of facts indicating that a patent may not be valid and there is a public interest in invalidating defective patents. Most licensee restrictions, however, are readily enforceable, particularly when they merely speak to the scope of the license that is granted. For instance, a licensee may be restricted to a particular field of use, such as consumer products.

Foreign Rights

Rights in technology may be secured in various ways under applicable laws of the many countries in the world. Entities that conduct international business in goods and services are
commonly confronted by the daunting task of negotiating an agreement that accounts for all applicable rights in all countries involved. Forms of intellectual property rights, available remedies and enforcement procedures vary widely from country to country. Prospective licensors and licensees must remain alert to the shifting legal requirements and limitations applicable to the forms of technology, associated rights and contemplated agreements that the parties intend to rely upon to control a transaction. For example, several countries restrict the patenting of medical treatments of the human body, impose limitations on suitable trademarks and require so-called working of a protected technology within the country in order to maintain associated rights against third parties.

Against this background, licensees should strive to consummate a license agreement that will resolve all issues surrounding a technology of international significance in the manufacture, sale, use, importation and other commercial activity in every host country involved. Licensors should strive to exact the full licensing benefit from the technology (and not necessarily in symmetrical or uniform format) in each host country involved.

Tax Considerations

There are several tax issues associated with license transactions involving intellectual property. The following is an overview of tax issues that might arise.

Developing Property to Be Licensed

The ability to deduct the costs of developing intellectual property to be licensed can be a significant tax issue. Research and development costs are generally deductible even if the company is not yet, but will be at some point, engaged in a trade or business activity involving the intellectual property. Current deductions for such costs (compared with capitalizing such amounts) usually makes the most sense for a company that wants to license the developed technology, because there is no cost recovery of the capitalized amount if the technology is considered for tax purposes to be licensed.

Capitalizing research and development costs is possible, and may be desirable if the company has no current income and wants to reduce its gain on disposition of some or all of its interests in the developed intellectual property in the future.

Acquiring Intellectual Property by License

A licensee acquiring rights to use intellectual property usually wants the fastest cost recovery possible. If a transaction is considered a license for tax purposes, the licensee should be able to claim royalty deductions in accordance with its method of accounting (cash or more likely, accrual) for such expenses. However, the cost of a paid-up license may not be deductible in the year paid, even for a cash basis taxpayer. Rather, the cost would be
amortized over an appropriate period of time (such as the remaining life of the applicable patent or other term of the license).

If the royalty is being paid to a foreign licensor from a U.S. licensee, U.S. withholding tax considerations must be taken into account. The U.S. statutory withholding rate for outbound royalties can be as high as the corporate tax rate in recognition of obligations to countries with which the United States has no tax treaties. Most income tax treaties lower this rate, and some exempt royalties from withholding altogether. These issues should be dealt with in the license agreement explicitly.

As discussed below, the tax characterization of the transaction as a license is quite important. If intellectual property is acquired in a purchase and sale transaction, the buyer may be required to use a 15-year, straight-line amortization cost recovery method.

**Disposing of Intellectual Property by License**

A licensor granting rights to use intellectual property usually wants to defer any income recognition event as long as possible. If a transaction is considered a license for tax purposes, royalty payments are taxable to the licensor when the royalty income is properly taken into account under the method of accounting used by the taxpayer.

For example, under the accrual method of accounting, a licensor is required to report royalty income as soon as the unconditional right to the income exists and the amounts can be determined with reasonable accuracy. The time at which income may be deemed “accrued” may be before any of the royalties are actually received, and thus, licensors should be aware of the effect of placing unconditional payment terms in license agreements. In addition, there is an exception to the accrual method of accounting for upfront cash royalties received that are taxed upon receipt even if an unconditional right to keep the amounts does not yet exist. Thus, the income accrual issues can be quite important from a tax liability, cash flow point of view.

If the royalty is being received from a foreign licensee by a U.S. licensor, foreign withholding tax considerations must be taken into account. Several countries around the world have withholding tax systems to tax outbound royalty payments. Most income tax treaties lower this rate, and some exempt royalties from withholding altogether. A U.S. taxpayer that is required to bear the burden of any foreign withholding tax should attempt to obtain a foreign tax credit in the United States for such amounts. The foreign tax credit rules in the United States are complex, but can yield very beneficial results to avoid double taxation of the same income.

Characterization of the transaction as a license can be quite important. If intellectual property is disposed of in a purchase and sale transaction, the seller might be able to achieve long-term capital gain treatment and avoid ordinary income treatment for the gain.
on the disposition of the intellectual property. Even if a transaction were a sale, however, several factors would need to be considered before the benefits of long-term capital gain treatment would be allowed. Inventors of patented technology are specially accorded capital gain treatment for proceeds derived from the sale of patent rights. Characterization of a transaction as a sale or a license is also important because withholding taxes usually do not apply to sale or exchange transactions, but often do apply to license arrangements.

**Structuring Issues**

Certain licensing arrangements are conducive to special tax considerations if structured properly. For example, instead of paying license fees for patent rights, a licensee may convey a license under its own patents to the licensor in a cross-license arrangement. In a sense, the potential income likely to be received by any one party in a cross-licensing arrangement is offset by the business expenditure for license fees that such party would pay to the other party, provided a number of factors are favorably satisfied by each party to the transaction. There are not many tax authority guideposts on cross-licensing, and the IRS could treat the parties as if they had paid each other the license fees for tax purposes.

Special tax considerations should be given to structuring a so-called paid up license for technology rights that have an expected useful lifetime exceeding the term of the license. In those situations, the entire sum paid by the licensee (for example, upon signing the agreement) may not be deductible as an ordinary business expense in the year of payment, but rather may have to be amortized over a period of time, which could be as long as 15 years.

Also, casual or routine transfers of intellectual property rights among related companies should be specially scrutinized to avoid such profound tax consequences as an adverse determination that such transactions constitute constructive dividends or non–arm’s length transactions, with associated taxes and penalties due.

The structure of a *bona fide* license arrangement can also have an impact on the timing of the royalty income to be reported, as noted above.

**Transaction Characterization Issues**

The characterization of intellectual property licenses for tax reasons as *bona fide* licenses can have very significant financial impacts on both the licensor and the licensee. It is therefore crucial for parties to a license agreement of any significant size to have tax counsel review and comment upon the proposed arrangement at the early stages. Often, such forethought can lead to a more advantageous result for both the licensor and the licensee.

For example, an exclusive license that conveys substantially the entire rights and interests (but not title or ownership) in a patented invention may incur for the licensor the burden of
paying taxes on the ordinary income received as license fees and royalties. Instead, it may be preferable to structure such a conveyance as a sale to qualify for capital gains treatment, and thereby yield significantly greater after-tax returns to the patent holder.

For the transfer of intellectual property (especially a patent or know-how) to qualify as a “sale or exchange,” “all substantial rights” to the intellectual property must be transferred to the buyer. The fact that a contract is called a “license,” or that the payments are called “royalties,” is not important in determining whether the transfer is a sale. The issue is what rights are “substantial.”

Generally, the following factors are considered indicative of substantial rights: exclusivity; duration for the remaining useful life; right to prevent unauthorized disclosure; restrictions on disclosure; right to use the property produced by the know-how; and sublicense rights.

Mere field of use limitations, geographical limitations, restrictions on assignment and on quality standards, and transfer of all remaining rights after the know-how was previously licensed to a third party may inhibit sale or exchange treatment in certain instances under existing authorities.

The following rights have generally been determined not to be “substantial” rights: certain rights to reacquire following events over which the transferor has no control; termination on default; termination upon insolvency or bankruptcy; payments contingent upon use of the know-how; indemnification for infringements; termination for failure to make minimum sales; and transferee’s rights to terminate.

Foreign country characterization issues also can arise in addition to U.S. characterization issues. Countries such as Japan and Korea have become quite sensitive to these issues.

Sales and Local Tax Issues
Sales, use or district taxes may apply to the acquisition or disposition of intellectual property. In some states that have very limited occasional sales exceptions (such as California), the sales tax issues can be very significant. Certain types of property taxes might apply to intellectual property transfers as well.

The Parts of a License
A license is a particular type of contract that must contain certain elements in order to be binding. Put simply, a license must specify the property to be licensed and the particular rights to that property that are licensed; must identify the parties and indicate what each is to give and receive as “consideration”; must be sufficiently complete and specific to
establish that there was a “meeting of the minds” between the parties; must show that
the parties actually agreed to and accepted the terms of the license; and must not contain
provisions that could invalidate or render unenforceable all or part of the agreement
prepared by the parties.

Although in some instances a license that is not reduced to writing may be enforceable,
written licenses are common in most commercial contexts. Depending upon the nature and
value of the license, a written and signed license agreement may be a legal prerequisite
to any enforceable rights. For example, an exclusive license to a copyright must not only
be written, but must also be recorded in the U.S. Copyright Office to be effective against
subsequent parties who claim a right to the same work.

Listed below are the major parts of a typical license agreement.

Recitals
The recitals of a license, often comprising a number of paragraphs beginning with
“Whereas,” are generally not considered to provide the operative terms of the license,
but instead provide the context of the circumstances surrounding the license. Oftentimes,
the recitals conclude by acknowledging that the parties have exchanged the valuable
consideration necessary to indicate that the agreement forms an enforceable contract, in
contrast to an unenforceable promise or a unilateral gift. For instance, a brief recital clause
and corresponding statement of consideration might read:

Whereas, company A ("Licensor") is owner of United States Patent number 6,123,456,
for Integrated Circuit Manufacturing Process ("the Patent"), and Whereas, company B
("Licensee") desires to obtain from Licensor certain rights under the Patent, Therefore,
in exchange of good and valuable consideration, the receipt of which is hereby
acknowledged, Licensor and Licensee agree as follows:

Definitions
There is no legal requirement that a license include a section defining the terms used
in the license, but when the license is lengthy or complex, or deals with arcane subject
matter, a definitions section can greatly increase the clarity of the license document, and
clarity may facilitate enforcement or understanding of what the parties intended if later
litigated. Alternatively, terms may be defined in the body of the license through the use of
parentheticals and capitalized terms, as in the above example.

Grant of License
No matter what other terms a license document includes, it should definitely include a clearly
articulated description of the nature of the license that is granted. This “grant” clause is
often the most important part of the license. As a rule of thumb, courts generally hold that
all rights not expressly granted by the licensor are reserved by the licensor. Nevertheless,
it is often good practice to specify in the grant clause what is not granted as well as what is granted, to avoid possible ambiguity. In some instances limitations to the grant may be inserted directly in the grant clause, while in other situations the limitations may be sufficiently complex as to require separate sentences, or even separate sections, to limit the scope of the grant. A simple example of a grant clause is:

Licensor hereby grants to Licensee a nonexclusive, nonassignable license under the Patent to make, use and sell products for the term of this agreement. In no event shall this agreement be construed to provide any license to practice any testing process or method.

**Payment**

Except for certain types of cross-licenses, almost all licenses contain some provision detailing the amount and type of payment to be made to the licensor. In some licenses, this information is embedded in the body of the agreement; in others, it is on a separate exhibit, attachment, schedule or other related document.

As mentioned above, royalties and other license fees may take a variety of forms, and the law places few limitations on the latitude afforded parties in consummating a license agreement.

Often the parties address the issues of withholding taxes applicable to license payments and who will be responsible for any applicable sales taxes in this part of the agreement.

**Ownership**

To ensure that the license is not interpreted as a transfer of ownership of the property, many licenses include language stating that ownership of the property remains with the licensor.

**Property Rights and Obligations**

As indicated above, the grant clause of a license should clearly articulate the grant, and the license should also clearly articulate the rights and obligations that each party retains, receives or incurs. For example, corresponding foreign rights in patents, trademarks, copyrights and trade secrets, to the extent that they exist and can be transferred and enforced, should be clearly defined in the conveyance (or in the reservations and restrictions), along with the obligations that such conveyances incur. The parties must commonly designate who shall be responsible for maintenance fees, working requirements, renewals, procedural compliances, policing and enforcement against infringers and the like, in order to ensure that the property rights are not lost, destroyed or otherwise adversely affected in each host country involved simply because of the conveyance of some or all of the rights involved under the license. Reversionary interests may have to be detailed following early termination for cause, or following expiration of a limited term license so that the licensor can retrieve the remaining rights after the license period. Also, the license should
detail each party’s obligations to pay various expenses, prosecute applications for grant of property rights, police and enforce against infringements and the like, in each host country.

**Housekeeping Provisions**

Many contracting provisions that are important for the smooth and orderly administration of a license agreement are incorporated into sections of the agreement that are loosely referred to as containing the “boilerplate” provisions. For example, where periodic payments such as royalties are payable under the license, conditioned upon net selling price or volume of sales or number of uses, records must be kept by the licensee from which the accuracy of payments can be assessed, and audit rights of such records as a mechanism for policing compliance with the licensing provisions are then also appropriate in the agreement. The parties usually consider the negotiated provisions of the license to be personal or unique between the parties, and therefore not transferable at will by a licensee. In addition, to obviate a source of possible confusion regarding the full extent of a licensing arrangement, a license agreement may specify that all prior agreements and all negotiations leading up to the current license agreement are abrogated, nullified and superseded by the current license agreement. Representations and warranties are commonly specified by each party as an inducement or as clarification of conditions or constraints regarding the agreement, and notice provisions are also recited in the licenses to facilitate alerting the parties regarding changed circumstances, default conditions, elective modifications of rights and the like.

**Resolving Licensing Disputes**

The most important measure that can be taken to resolve licensing disputes is to ensure that the parties initially reach true agreement as to all the important points of the license. All too often, parties will attempt to “paper over” differences in an agreement. The resulting facade of concurrence generally serves only to allow underlying areas of disagreement to fester until they reach a critical phase. Another common problem arises when the counsel for the parties do not understand either the technology or the nature of the arrangement that the parties desire. Sometimes this is due to the technology’s being intimidating to such counsel, and sometimes it is due to the parties’ not taking the time to fully discuss their objectives with counsel. In practice, it is clear that the likelihood of future disputes is drastically reduced when the parties truly reach agreement as to the licensing arrangement at the outset and clearly express their agreement in a written document.

Generally, license disputes are resolved in one of four ways: by one side acquiescing, by a negotiated settlement, by litigation or by one of several forms of alternative dispute resolution. Acquiescence by one side in a licensing dispute may seem attractive to the other side, but it is generally an undesirable situation because of the damage that typically occurs to the relationship between the parties. Even if the dispute over the particular license at
issue is resolved in such a manner, it is doubtful that the acquiescing party will want to engage in future relations with the winning party. Therefore, companies are typically well advised to put themselves in the position of the other party and seek a solution that is not one-sided.

Negotiation of license disputes generally picks up where the parties left off in negotiating the original license. Such negotiations should not be viewed necessarily as problematic, but instead as illustrative of ways that the licensing process may be improved in the future. One point of view is that the structure for negotiations should be set forth within the license, but a contrary opinion is that if parties in a dispute over a license cannot even informally agree as to a negotiating process, such negotiations would be doomed in any event. In general, the best basis for negotiating a satisfactory result to a license dispute is for the parties to recognize that a strong relationship between them in the future is probably more valuable than any short-term gain that might be achieved through a divisive approach.

Those who have endured the financial and human costs of litigation understand that it is correctly viewed as a last resort to license disputes. Where one party either ignores its obligations or improperly interprets the license in a manner damaging to the other party, litigation may be necessary to preserve the intellectual property rights or other interests of the aggrieved party. It must be remembered, however, that it is uncommon for either party to emerge truly victorious from a litigation, as the business disruption and expenses of modern litigation generally dominate.

In response to the difficulties of litigation, several popular alternative dispute resolution procedures have emerged. Primary among them are mediation and arbitration. Typically, mediation is a voluntary, nonbinding procedure where the two parties present their respective versions of the dispute before a neutral third party, who makes suggestions as to settlement of the dispute. The mediator typically does not present any suggestion as to which side appears more meritorious, although the mediator may privately suggest to each side the weak aspects of its case. Mediation can be particularly helpful in situations where emotions have come to play a significant role in the dispute, as is often the case. Many courts routinely refer litigating parties to mandatory mediation sessions in the discovery or pretrial phases of litigation.

Arbitration is a process by which the parties agree, typically in the license agreement, that disputes relating to the license will be resolved privately rather than in court. If the arbitration clause is properly drafted, courts will enforce such agreements to arbitrate and will not decide such disputes. There are several well-known organizations that conduct arbitrations. An arbitration hearing is much like a trial and is conducted before a neutral arbitrator (or panel of arbitrators) selected in accordance with the organization’s arbitration rules. Arbitration is intended to be faster, less expensive and more private than litigation.
in court, but it is currently viewed with skepticism by many technology and life sciences companies. Such skeptics argue that arbitration as currently practiced does not provide the touted benefits, and that arbitrators are more likely than courts to merely determine a compromise position than to choose a prevailing position.

Licensing of intellectual property rights is serious business, not to be conducted lightly or without full knowledge of the facts and controlling circumstances, or without full understanding among the parties regarding the impact of the licensing transaction being consummated. Care should be taken to ensure that all parties are fairly represented and are as completely satisfied as possible under the adversarial circumstances of a licensing transaction. This may promote cooperative and harmonious relationships between the parties following consummation of the arrangement and throughout the period of interaction between the parties under the terms of the agreement.