Types and Legal Terms of Technology License Agreements

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1. Typical Kinds of License Agreements – Exclusive, Non-Exclusive, “Sole” Licenses

License Agreements can provide for the transfer of rights to the licensee in many different manners.

A first kind of licenses, particularly in case of patents, are exclusive licenses, in which the patentee (or owner of secret know-how) does not retain any right to use the licensed technology, as an example, itself. In such a case, the licensor is left with the formal right and title in the respective patent etc., without any right to develop further activities in relation to the licensed subject.

A different kind of an exclusive license, often designated as "sole" license, means that the licensor grants an exclusive license with the exemption, however, that the licensor is entitled to continue using the licensed subject. In a strictly legal sense, according to German Law, even such a license can have a so-called factual effect, like an exclusive license, making it impossible for the licensor to dispose of the licensed patent etc. in any manner, different from non-exclusive licenses to be discussed below, even in cases where such a non-exclusive license contains the obligation of the licensor not to grant any further sub-license.

Strictly to be separated, under legal aspects, from the aforementioned two different kinds of exclusive licenses, in which, e.g., the licensor cannot dispose in any manner of the licensed patent etc. anymore, though possibly being entitled ("sole" license) to continue using the licensed right himself, are non-exclusive licenses. These can either be given in the manner that the licensor is not restricted at all to grant further non-exclusive licenses to third parties, but also in a manner in which the licensor undertakes not to grant any further non-exclusive
licenses to other parties. The latter is not an "exclusive license", however, rather there is only the legal, private obligation of the licensor towards the licensee not to grant any further licenses, with no effect for the factual ability of the licensor to dispose of the licensed right etc.

As one can imagine, of course the kind of license granted influences the amount of royalties and remuneration to the licensor, respectively, to be discussed lateron, the general rule being that the higher the exclusivity granted to a licensee, the higher the remuneration for the licensor.

Specific problems very often are created by the lack of understanding of the difference between a really “exclusive” license and a “sole” license. As an example from the own practice of the author: Not too long ago, a German manufacturer of medical instruments, of a not too big size, which thereafter became a client of the author of this paper, had a serious problem. The German company, having an excellent patent portfolio, but neither the personnel nor the money to develop production, got a very generous, as it seemed, offer to take an exclusive license under the major part of its patent portfolio, covering its main product, from an U.S. company. An exclusive license agreement was concluded, with a substantial initial down-payment, of a world-wide nature, whereafter the German company finally hoped to have the possibility to develop production to an extent that it could satisfy the demands of the German and even European market. Shortly after conclusion of the agreement, the German company was requested by the U.S. licensor to stop production, because of the existence of the exclusive license. Fortunately, because of the interest of the U.S. licensor in the continuing cooperation of the main inventor in the field in question and the respective future consultancy services, was prepared to renegotiate the deal to the extent that, based on the principle of various territorial restrictions, a solution which was acceptable to both parties could be found.

What the German company in this case had in mind, and thought to have concluded, was a “sole” license agreement, but unfortunately the whole character of the agreement, as well as the wording, just was different. Care must be taken in view of such pitfalls!
2. Minimum Royalties – A Way into Trouble?

When agreeing on minimum royalties in a license agreement, one should make sure that the parties clearly distinguish between the use of minimum royalties as an “insurance” policy in favour of the licensor, with the aim of giving the licensor the possibility to terminate the agreement, or, as an example, to modify an otherwise exclusive or sole license agreement into a non-exclusive license agreement, if certain minimum payments are not made. This use of minimum royalties, usually on a scale based on business plan principles, i.e. varying over the years of the lifetime of such a license agreement, makes a lot of sense.

Another type of minimum royalties, however, is sometimes agreed on in a form which imposes onto the licensee the obligation under all circumstances to pay certain minimum fees per calendar for a certain period of time, without a termination possibility for the licensee. This can be the way into bankruptcy, if the license product does not fly or other circumstances prevent the licensee from making successful use of the agreed on license. From the author’s viewpoint, an agreement on such a type of minimum royalties should only be made if in fact the minimum royalties are some kind of instalment payments for the transfer of know-how, whereby replacing an otherwise heavy initial down-payment, since otherwise the commercial uncertainties for the licensee might not be tolerable.

3. Warranties

Typically, in license negotiations the licensee will request the licensor to give three different kind of warranties, namely a) that the use of the licensed technology does not infringe any third parties’ rights, b) that the licensed patents are valid, c) that the licensed products have certain technical qualities, like yield in case of a chemical method of manufacturing etc., and d) that the licensed products do not do any harm to customers, users etc., i.e. product liability should be on the shoulders of the licensor.
Out of the aforementioned three types of typical warranty situations, c) is easiest to solve, since, from the viewpoint of the author, it is related to something which the licensor, by due diligence and knowing its technology, can rather easily agree on: Provided that the license agreement is absolutely clear with regard to the e. g. kind in which a yield should be measured, quality should be determined etc., such a warranty can be given based on full own experiences of the licensor with certainty.

It can only be warned against warranties of the kind as mentioned under a) and b) however: The licensor, under no circumstances, can be sure that the licensed patent(s) are valid, since it is always possible that a certain piece of prior art shows up which never was found in any earlier search. The same applies for third parties’ patents as mentioned under b).

It is therefore strongly recommended to agree in license agreements only on clauses of the type that the licensor assures that according to its best knowledge the patent(s) is/are valid and the licensed technology does not infringe any third parties’ rights.

Also, product liability, as listed under d) above, is extremely critical. The licensor usually is neither familiar with use in control of the specific market situations the licensed technology is subjected to, and accordingly it would not appear as fair to burden such a kind of “warranty” to the licensor.

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