

USING LICENSING TO PROTECT YOUR INNOVATION

By Joel G. MacMull

For budding entrepreneurs who have the fortitude to actually bring their ideas to market and not simply talk about them, few things are as appealing as the idea of licensing their innovation to the masses. Often, in doing so, the anticipation of unlimited income streams follows. This income – often important from an innovative standpoint – can give rise to previously unattainable research and development efforts, or just as importantly, a full-scale marketing blitz complete with all the fancy bells and whistles afforded by today’s technology.

But a question I’m often asked (okay, well, I’m not asked the question *that* often, but I’d like to be) is how to best balance the trade-off of access to new markets and, therefore, create a larger customer base for your innovation, with the always important issue of control, or more importantly, how to hang on to it. This is one of the more delicate balancing acts when a start-up or small company elects to license its intellectual property (“IP”) and it must always be measured against the particular circumstances of any prospective deal. However, certain “truisms” of the practice emerge. The guidelines set forth below are equally applicable to both the experienced licensor as well as the less-sophisticated novice.¹

Reduce Everything to a Written Record and Keep it Organized

Paper, when it’s organized, intimidates. Period. A party who is well-organized in the way that they retain and present their documents in a transaction or litigation immediately has the upper-hand. A licensor’s (the person giving the license) good record-keeping instills in a prospective licensee (the person being granted a license) a certain confidence, which is important at the deal stage. First, it shows prospective purchasers or “licensees” that you should be taken

¹ A good introduction to licensing intellectual property is A. Poltorak & P. Lerner, *Essentials of Licensing Intellectual Property* (2004).

seriously. Papers stained with coffee and placed haphazardly in an accordion folder don't convey the same impression.

Second, organizing records allows for easy due diligence by third parties who may be interested in acquiring your IP.

Third, should a dispute arise between you and your licensee (and they will to varying degrees), the advantage goes to the party whose house is best kept in order. Being able to easily locate agreement documents, royalty payment remittances and IP registrations, among other things, will allow for easier enforcement of particular licensing terms if things go awry. (By way of example, lawyers can't write importance enforcement letters, if the terms of the license cannot easily be ascertained.) Which brings me to my next point...

Enforce, Enforce, Enforce

Foolishly, a lot of would-be and current IP rights' holders (in my experience, this applies equally to owners of copyrights, trademarks or patents) are under the mistaken impression that as soon as they obtain their respective registrations, easy money will follow. More problematic is that some rights' holders think that lying in wait, and allowing a junior user to use their IP for a time, only to later spring on them a cry of "infringement" is the best way to proceed. However, these individuals are under the mistaken belief that allowing a non-authorized user to use their IP will result in a bigger payday when they do choose to act. Wrong! Allowing the use of your IP by an unauthorized party is never good. Ever.

Legal defenses arising under theories of waiver, laches (pronounced like "latches") and/or acquiescence, though they each apply a little differently, all deal with the same basic principle: they serve to bar a party's recovery because of undue delay in seeking relief.

Applying this then to the licensing context means that once you obtain your IP registration, you **must** pay attention to how it's being used by others. Parties who may be infringing on your IP rights don't have to be doing it on purpose for their use to constitute infringement. There is no intent requirement for most IP infringement claims as there are in other areas of the law.

So what to do? How does an IP rights' holder stay on top of other, potentially infringing uses to protect one's own interests? First, contact a lawyer. Really. It's perhaps the single most important step you can take in safeguarding your IP. Second, discuss with your lawyer how to sign up for IP monitoring services. Though these services charge a fee, the benefits can far outweigh their cost. Perhaps the single greatest gain to be had from an IP search service is that it can protect your IP investment for the future. Nothing is a greater deal killer and disappointment to an IP owner than when a prospective buyer discovers through their own due diligence that your IP is being used by a half dozen others. An after-the-fact discovery like this can dilute your entire IP strategy and render it nearly valueless.

It's Okay to Negotiate the License, but Be Mindful of Certain Drafting Traps

Notwithstanding the above recommendation to retain a lawyer skilled in licensing IP transactions and enforcement, invariably certain entrepreneurs – and not unjustifiably – will decide that they, and not a lawyer, know what's best for their business to grow. With that reality in mind, here are a couple things to remember:

- **Don't be intimidated by the license agreement itself.** That is, don't assume that what you're offered is "take it or leave it" even if it's presented that way. Trust your gut. After all, you're a smart entrepreneur and if something doesn't seem right, it probably isn't. If you're not comfortable with certain terms, suggest alternatives without being

piggish. Provisions concerning royalty structures, the agreement's duration, quality control procedures, IP enforcement/ownership and product or service "buy-backs" are only a few of the many items in a license that can be negotiated. And frankly, some negotiation is to be expected in any licensing arrangement, even if it's accompanied by moans and groans to the contrary.

- **Negotiate exclusivity with great care.** As in all things, exclusive arrangements can be both a blessing and a curse. More often than not, for small companies and startups, they're a curse. Larger companies wishing to incorporate your IP into their own line of products or services will typically demand exclusivity. And why shouldn't they? So the thinking goes, "We found you first, therefore we're entitled to everything you've got." Further, they figure that you're a small company and can be seduced by big talk and promises of big money. As a small or young company, however, you may not appreciate the full potential of your IP. You may not realize that with a little time and effort, along with access to the right channels, your little "widget" just might become the next Facebook. Balancing these potential gains with certain economic realities is key. One way to ensure balance in any licensing arrangement is by building into the agreement milestones and performance-based measures to determine whether the anticipated growth you're hoping for is actually realized by your licensee. Recognize that once your IP is in the hands of a licensee, rarely do you have control over the way it's put out to market. Consequently, it's important to build into the agreement itself whatever control mechanisms you think are important. Given the complexities that come along with exclusivity provisions, this is often one of the more sensitive issues in most license negotiation.

- **Beware of certain drafting traps.** For this reason alone, you should hire a lawyer. But if you decide to negotiate your own license agreement beware of at least two common, but often overlooked traps for the unwary. First, realize that a license can be “assignable” or “nonassignable.” An “assignable” license is one that may be transferred or “assigned” by the licensee to a third party, which effectively replaces the original license. A “nonassignable” license is one that may not be assigned. In practice, many licenses are a combination of these two approaches and are assignable under a set of narrowly tailored conditions. The assignability of a license is important when considering the license’s payment scheme. If a payment for a license agreement is entirely front-loaded, called a “paid-up” license (when a licensee pays a single one-time lump sum payment at the beginning of the license term in lieu of any future royalties), the license should be nonassignable. Few things are more demoralizing to an IP owner than to grant a paid-up license to a small company, for a corresponding small sum, only to later realize that the licensee has assigned the license to much a larger company who then makes much more extensive use of the licensed rights, but pays absolutely nothing for them. If assignability of a paid-up license ultimately becomes a deal breaker, build into the agreement a limitation on the usage rights that a licensee can grant to any future assignee. This is accomplished by limiting any future assignee to the licensee’s level of use immediately prior to the assignment. The other thing to watch out for and, frankly, this should be nonnegotiable, is that each and every license should provide for the immediate termination of the license upon the insolvency or the filing of bankruptcy of a licensee. Otherwise, the assets of the licensee, including its IP, may be sold for a pittance to a new buyer who then may acquire your IP without having to pay anything for it.

Engage with Your Lawyer

When the day is done, the single greatest thing any entrepreneur can do is to become familiar with the legal environment in which they operate. Ask questions. Specifically, don't be afraid to ask why certain clauses are drafted in a particular fashion because lying behind the technicalities of the language lurk important legal reasons for why things are drafted the way they are. Teaming up with your lawyer will also help you build confidence as you move forward and engage in other opportunities.