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# Overview of Licensing and Technology Transfer

by Homer O. Blair\*

## PART ONE—*Nature of the Items to be Licensed: Patents, Trade Secrets, Know-How, Trademarks, and Copyrights*

Licensing is not merely the legal aspect of preparing an agreement; rather it is the entire process of preparing a business plan, searching out an appropriate technology or licensee, structuring the business arrangement, negotiating the agreement, insuring an adequate technology transfer, and administering the agreement.<sup>1</sup> The process requires a variety of skills and may take years to complete.

Licensing may be defined as the purchase, sale or exchange of certain rights relating to proprietary assets in which the licensor permits the licensee to make or sell products, or use products or processes which involve inventions (patents), special knowledge (trade secrets and know-how), names (trademarks), or the form or appearance of an original work (copyrights).<sup>2</sup> In the above definition, "intellectual property" and "industrial property" are terms sometimes used interchangeably with "proprietary asset." Although all three terms are meant to include copyrights, trade secrets and know-how, trademarks, and patents, the term "industrial property" does not always include copyrights.<sup>3</sup> These five are the items which are being licensed. This article will discuss what the items are and what one can and cannot do with them.<sup>4</sup>

## I. Patents<sup>5</sup>

### A. *Constitutional Basis*

The United States Constitution, article I, section 8, sets forth eight-

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<sup>1</sup> See Arnold, *Basic Considerations in Licensing*, in DOMESTIC AND INTERNATIONAL LICENSING OF TECHNOLOGY 35 (Practicing Law Institute 1980).

<sup>2</sup> *Id.* at 35-36.

<sup>3</sup> P. ROSENBERG, PATENT LAW FUNDAMENTALS 1-19 (2d ed. 1982).

<sup>4</sup> See H. BLAIR, UNDERSTANDING PATENTS, TRADEMARKS, AND OTHER PROPRIETARY ASSETS AND THEIR ROLE IN TECHNOLOGY TRANSFER AND LICENSING — THE PRACTICAL VIEW (1978).

<sup>5</sup> For further information about patents, see T. ARNOLD & F. VADEN, INVENTION PROTECTION FOR PRACTICING ENGINEERS (1971); THE ENCYCLOPEDIA OF PATENT PRACTICE AND INVENTION MANAGEMENT (R. Calvert ed. 1964); E. KINTER & J. LAHR, AN INTELLECTUAL PROPERTY LAW PRIMER—A SURVEY OF THE LAW OF PATENTS, TRADE

een powers of Congress. These powers include the power to collect taxes, to borrow money, to coin money, to declare war, to raise and support armies and navies, and the power "to regulate commerce with foreign Nations, and among the several states."

The United States Constitution, article I, section 8, clause 8, gives Congress the power "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Rights to their respective Writings and Discoveries."<sup>6</sup> This clause is unique because it is the only clause that both sets forth a power and tells Congress how to exercise that power. This is the clause that results in our patent and copyright laws.

Some commentators have argued that Congress does not have the power to give inventors awards under this clause but only has the power "to confer on the authors of useful inventions an exclusive right in their inventions for the time mentioned in their patent."<sup>7</sup> The power to give inventors recognition by monetary awards, medals, and titles must therefore come under another power.

### *B. Monopoly*

Frequently, patents are referred to as "monopolies," but nowhere in our law is the inventor of a patented invention given the right to make, use or sell anything. Moreover, the inventor is not attempting to obtain a "monopoly" on something which previously belonged to, or was freely available to, the public, but rather is giving something to the public which they did not have before. Once an inventor has received a patent from the United States Patent and Trademark Office, patent laws provide that "whoever . . . makes, uses or sells any patented invention within the United States during the term of the patent therefore, infringes the patent."<sup>8</sup> Under federal law, a grant of a patent to a patentee is effective for a term of seventeen years, subject to the payment of requisite fees.<sup>9</sup> Congress has also provided that "[a] patentee shall have remedy by civil action for infringement of his patent,"<sup>10</sup> and that courts may "grant injunctions . . . to prevent the violation of any right secured by a patent. . . ."<sup>11</sup> Moreover, "[u]pon finding for the [patent] claimant the court shall award the claimant damages" to compensate for the infringe-

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SECRETS, TRADEMARKS, FRANCHISES, COPYRIGHTS, AND PERSONALTY AND PROPERTY (N.D.); P. ROSENBERG, *supra* note 1; 3 P. SPERBER, *INTELLECTUAL PROPERTY MANAGEMENT: LAW BUSINESS STRATEGY* (1974); U.S. DEP'T OF COMMERCE, *GENERAL INFORMATION CONCERNING PATENTS* (1974); U.S. GOV'T PRINTING OFFICE, *DO YOU KNOW YOUR ECONOMIC ABC'S?, PATENTS SPUR TO AMERICAN PROGRESS* (1969); U.S. PATENT & TRADEMARK OFFICE, *QUESTIONS AND ANSWERS ABOUT PATENTS* (1979).

<sup>6</sup> U.S. CONST. art I, § 8, cl. 8.

<sup>7</sup> *Grant v. Raymond*, 31 U.S. (6 Pet.) 218, 241 (1832).

<sup>8</sup> 35 U.S.C. § 271(a) (1976).

<sup>9</sup> 35 U.S.C. § 154 (Supp. V 1981).

<sup>10</sup> 35 U.S.C. § 281 (1976).

<sup>11</sup> 35 U.S.C. § 283 (1976).

ment.<sup>12</sup> While the inventor is not given a statutory right to practice his invention, he is given a statutory right to prevent others from practicing his invention, which is frequently referred to as a right to exclude others from making, using or selling his invention.

The following illustration is helpful. When Alexander Graham Bell received his patent for the telephone, he had the power to prevent anyone else from making, using or selling a telephone. Assume that someone else later invented a dial telephone for which he also received a patent, as an improvement on Bell's telephone. This second inventor would then be able to prevent anyone else, including Bell, from making, using or selling a dial telephone. This sets up the necessity for licensing. In order for a third party to make, use or sell a dial telephone, two licenses are needed; one from Bell under his basic telephone patent, and another from the second patentee under his dial telephone patent. Thus, even Bell would need a license from the inventor of the dial telephone in order to make a dial telephone, and the inventor of the dial telephone would need a license from Bell under Bell's basic telephone patent in order to make, use or sell the dial telephone.

This is a difficult point for business people to understand, but it may be vital in negotiating a license agreement. For example, if the licensor owns patents or technology and the licensee obtains a license under those patents, the licensee must, nevertheless, be aware of patents owned by others. As can be seen from the previous example, an organization could take a license from the inventor of the dial telephone, and still need a license from the holder of the basic telephone patent. Thus, the licensee may be required to make some significant patent investigations before signing the license agreement or going into production. Some aspects of this problem can be handled in a license agreement as mentioned below.

### *C. Territory*

A patent is issued by a particular government and only covers actions that take place within that government's jurisdiction. For example, a United States patent does not prevent anyone from making, using or selling the invention in Canada, the United Kingdom, Japan, the People's Republic of China or any other place in the world.<sup>13</sup> When an inventor is attempting to obtain patents on an invention, he must decide, at an appropriate time, whether he wishes to obtain patents in other countries and, if so, which countries.

Unfortunately, obtaining wide patent coverage can be extremely expensive. Often a particular piece of equipment will be covered by a number of patents. If the product is to be sold in several countries, the inventor may wish to get patents on each feature in all countries of interest. At present, it costs approximately \$1,000 per invention to file a pat-

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<sup>12</sup> 35 U.S.C. § 284 (1976).

<sup>13</sup> 35 U.S.C. § 154 (Supp. V 1981).

ent application in foreign countries.<sup>14</sup> Thus, if a piece of equipment is covered by ten patents, which the inventor wishes to file in twenty countries, the cost is \$200,000. In addition, it may require substantially more money to get the patents issued in the various countries involved.

#### *D. Patent Applications*

An application for a patent filed in the U.S. Patent and Trademark Office is kept secret until the patent is issued.<sup>15</sup> There are no rights to exclude others from making, using or selling the invention in the United States until the patent is actually issued by the U.S. Patent and Trademark Office.<sup>16</sup> Thus, while a notification that a patent application is pending may be useful as a warning, it does not prevent anyone from using the invention until the patent actually is issued.

It should be kept in mind that patents are frequently issued or published in other countries before they are available in the United States. Patent applications are published in a number of countries eighteen months after the initial filing date in the first country.<sup>17</sup> Frequently, the contents of a U.S. patent application, and sometimes even a photocopy of the U.S. patent application, can be obtained legitimately through foreign patent offices eighteen months after it is filed in the United States.

#### *E. Information Disclosed in Patents*

Substantial advantages accrue from filing a patent application as early as possible. In most countries, the inventor who files first receives the patent.<sup>18</sup> In the United States, the "first to invent" receives the patent,<sup>19</sup> but the first inventor to file a patent application receives certain procedural rights. This creates substantial pressure on the inventor to file the patent application as soon as possible.

An early version of an invention, such as a laboratory model, is usually the only information that the inventor has available at the time the patent application is filed. When commercial technology of any sophistication is involved, the issued patent generally does *not* include actual commercial details. Such details nearly always develop *after* a patent application is filed. A patent will disclose the principles of the invention and a preferred embodiment, but the actual commercial details are usu-

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<sup>14</sup> See Patent Filing Fees, 47 Fed. Reg. 41,273 (to be codified at 37 C.F.R. §§ 1.16-1.18).

<sup>15</sup> 35 U.S.C. § 122 (1976).

<sup>16</sup> See P. ROSENBERG, *supra* note 3, § 18.03.

<sup>17</sup> U.N. Educational, Scientific & Cultural Organization, U.N. Conference on Trade & Development, and World Intellectual Property Organization, The Role of the Patent System in the Transfer of Technology to Developing Countries ¶ 155, U.N. Doc. TD/B/AC.11/19/Rev. 1 (1975) (hereinafter cited as UNESCO, UNCTAD, & WIPO).

<sup>18</sup> See P. ROSENBERG, *supra* note 3, § 19.01[4].

<sup>19</sup> 35 U.S.C. § 102(g) (1976). "In determining priority of invention there shall be considered not only the respective dates of conception and reduction to practice of the invention, but also the reasonable diligence of one who was first to conceive and last to reduce to practice, from a time prior to conception by the other." *Id.*

ally not available at the time the patent application is filed, and additional technical information is often needed to supplement the information disclosed in a patent in order to manufacture a product without substantial development costs. For that reason, it is sometimes complained that patents do not contain sufficient commercial information.<sup>20</sup> It is interesting to note, however, that when a patent application is filed in most foreign countries based on a U.S. patent application, the foreign patent office frequently requires information to be deleted because there is "too much" disclosure.<sup>21</sup>

### *F. What Patents Cover*

Typically, patents include "a specification" describing the invention. Specifications frequently consist of a drawing and one or more numbered sentences at the end of the patent, which are referred to as "claims" because they set out the metes and bounds of the actual invention.<sup>22</sup> When a patent lawyer wishes to see what is covered by a patent, he reads the "claims." The other portions of the patent merely describe and explain the invention. For example, Thomas Edison's electric light patent included, as Claim 1: "An electric lamp for giving light by incandescence consisting of a filament of carbon of high resistance made as described, and secured to metallic wires, as set forth."<sup>23</sup> Thus, Edison's invention was not the first electric light but was an electric light having a high resistance carbon filament secured to metallic wires which, when electric current flowed through it, gave off light by incandescence. Earlier electric lights were not practical because of their short life. Thus, Edison's contribution was the first practical commercial electric light.

Statements that a certain individual or company has a patent covering a particular item should be taken with a grain of salt until a patent attorney has actually reviewed the claims. It is perfectly legitimate, when discussing patents with others, in license negotiations or otherwise, to ask them for copies of their patents or the numbers of the patents so that a copy may be obtained. Patents are public documents, published by the U.S. Government, and available to anybody for one dollar a copy.<sup>24</sup>

### *G. Patent Life*

In the United States, a patent lasts for seventeen years after the issue date.<sup>25</sup> In the past, once a patent was issued, nothing was required to keep the patent in effect. Now, however, due to recently enacted legisla-

<sup>20</sup> See UNESCO, UNCTAD, & WIPO, *supra* note 17, ¶ 305.

<sup>21</sup> See P. ROSENBERG, *supra* note 3, § 19.01[2].

<sup>22</sup> See *id.* § 13.04[6].

<sup>23</sup> U.S. Patent No. 223,898 (granted to Thomas A. Edison on Jan. 27, 1880).

<sup>24</sup> See Patent Supply Fees, 37 Fed. Reg. 41,273 (to be codified at 37 C.F.R. § 1.19(a)(1)).

<sup>25</sup> 35 U.S.C. § 154 (Supp. V 1981). See P. ROSENBERG, *supra* note 3, § 1.06.

tion, one must pay taxes three and a half, seven and a half, and eleven years after the patent was issued, or the patent will cease to exist.<sup>26</sup> In most foreign countries, annual fees or "maintenance taxes" are required to keep the patent in existence.<sup>27</sup>

#### *H. Cost to Obtain Patent*

Recently, the fees to obtain patents in the United States have been substantially increased.<sup>28</sup> The fees payable to the government to obtain an issued patent will be approximately \$1,000. It usually costs substantially more than this, however, for a patent attorney to prepare the patent application and guide it through the U.S. Patent and Trademark Office. The original invention disclosure prepared by the inventor is usually several paragraphs in length. Using this short invention disclosure, a patent attorney, who has at least one technical degree, must prepare a patent application which will run anywhere from ten to fifty double spaced pages and which may contain a number of pages of drawings. The patent application is reviewed by the inventor, often changed by the attorney to incorporate the inventor's comments, and finally filed in the U.S. Patent and Trademark Office. The proper preparation of such a document will take many hours. As Mr. Justice Brown stated for the Supreme Court in *Topliff v. Topliff*,<sup>29</sup> "[t]he specification and the claims of a patent, particularly if the invention be at all complicated, constitute one of the most difficult legal instruments to draw with accuracy. . . ."<sup>30</sup>

## **II. Why Get Patents?**

### *A. Advantages*

First, the patent system prevents competitors from copying inventions obtained through years of research and development. This is particularly important when a small company is attempting to get started. For example, without a patent system, Polaroid Corporation probably would have been unable to introduce and continue to sell its "instant" film and cameras, since its much larger competitors would have copied its developments and, with their superior marketing and financial power, would have forced Polaroid out of business. For similar reasons, Xerox Corporation probably would not have been successful entering the photocopier business without the patent system. Patents are one of the

<sup>26</sup> 35 U.S.C. § 41(c) (Supp. V 1981).

<sup>27</sup> See A. GREEN, PATENTS THROUGHOUT THE WORLD 480-83 (2d ed. 1982).

<sup>28</sup> 35 U.S.C. § 41(a) (Supp. V 1981) gives the Commissioner of Patents authority to set fees. Recent changes in the fee schedule are set out in 47 Fed. Reg. 41,273 (to be codified at 37 C.F.R. §§ 1.16 to 1.18).

<sup>29</sup> 145 U.S. 156 (1892).

<sup>30</sup> 145 U.S. at 171.

few things that a small company can use to compete successfully against a large company.

Second, patents are extremely useful in licensing and joint venture business arrangements, since they provide a mechanism for preventing others from using the invention without permission.

Third, since technology is disclosed when the patents have issued, the developer of the technology does not have to keep the invention secret. Thus, the patent system encourages publication and dissemination of information.

### *B. Disadvantages*

The major disadvantage of the patent system today is the difficulty and expense of patent infringement suits. In any patent suit involving technology of even moderate sophistication, the legal fees for each side will be a minimum of \$500,000. Often, an individual or small company cannot afford such fees and must attempt the difficult task of finding a lawyer who will take the suit on a contingent fee basis.

Also, the uncertainties of patent validity give rise to numerous patent suits, and many companies feel it is worth their time to fight nearly every suit, since there is a fairly good chance that they will win. Unless something is done to either strengthen the validity of patents or reduce the time and expense of determining patent validity, the patent system is likely to be used less and less in the future, particularly by individuals and small companies.

Another disadvantage of the patent system is that competitors will learn about the new technology when the patent is published. If the technology is the type that cannot be readily determined from inspecting a product, disclosure is particularly disadvantageous. A possible alternative to disclosure is discussed below.

## **III. Trade Secrets and Know-How<sup>31</sup>**

A trade secret may be defined as "any formula, pattern, device or compilation of information which is used in one's business, and which gives [one] an opportunity to obtain an advantage over competitors who do not know or use it."<sup>32</sup> The term "know-how" is broad enough to include, but is not limited to, trade secrets. Know-how also may include items that do not constitute secrets, but are nevertheless unknown to someone willing to pay for them. Trade secrets and know-how are often included in licensing agreements and are sometimes included in a defini-

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<sup>31</sup> For further information about trade secrets, see M. JAGER, *TRADE SECRET LAW HANDBOOK* (1982); R. MILGRIM, *BUSINESS ORGANIZATIONS: TRADE SECRETS* (1982).

<sup>32</sup> *RESTATEMENT OF TORTS* § 757 comment b (1939), discussed in R. MILGRIM, *supra* note 30, §§ 2.3 to 2.12.



tion of proprietary information.<sup>33</sup>

While patents may be very important in licensing agreements, usually they are not as important as the trade secrets or know-how, which is the information that will actually teach the licensee how to do the particular thing being licensed. Most agreements, therefore, include both patents and know-how.

It is much easier to license know-how and patents than it is to license pure patents. With a patent license alone a licensee will have to do a significant amount of work to develop the technology to the point where it can be practiced commercially, unless the patent is a very simple one.

Trade secrets are often the item that permits a company to make a product that cannot be copied by its competitors. Some commentators have said that the most important thing Eastman Kodak Corporation owns is the know-how to coat and make various photographic materials. The exact conditions and the particular materials used are much more important than the Kodak patents covering the company's various film coatings. Even if Kodak had no patents, it would be nearly impossible for another company to compete in these areas. Another famous trade secret is the formula for Coca-Cola, allegedly known to very few people.

A trade secret or know-how has an indefinite life if it can be kept secret. Some trade secrets become known a fairly short time after the product involved has been sold, while others, such as the Coca-Cola formula, may remain secret for many years.

#### IV. Trademarks<sup>34</sup>

A trademark is *not* the name of a particular product. Nor is it the generic name of a product. It should be thought of as a brand name of a product, very much like a person's first name, with the last name being the generic product. For example, "Kodak" is a well-known trademark for a brand of cameras. In that case, "camera" is the generic name of the product. A trademark is nearly always an *adjective* modifying a *noun*, which is the generic name. It is a brand mark. When talking of trademarks, probably one of the best ways to remember what is and what is not a trademark is to use the word "brand" after every trademark. Some companies do this in an effort to protect their trademarks, which may be in danger of being lost when the general public begins to use them to

<sup>33</sup> See 2 R. CALLMAN, THE LAW OF UNFAIR COMPETITION: TRADEMARKS AND MONOPOLIES § 14.08 (4th ed. 1981).

<sup>34</sup> For further information on trademarks, see M. BERAN, AN INTRODUCTION TO TRADEMARK PRACTICE (1974); S. DIAMOND, TRADEMARK PROBLEMS AND HOW TO AVOID THEM (2d ed. 1981); J. GILSON, TRADEMARK PROTECTION AND PRACTICE (1982); A. GREENBAUM, CURRENT DEVELOPMENTS IN TRADEMARK LAW (1976); D. KAUL, GENERIC TRADEMARKS (1981); U.S. DEPT OF COMMERCE, GENERAL INFORMATION CONCERNING TRADEMARKS (1981); U.S. TRADEMARK ASS'N, TRADEMARK LAW HANDBOOK (1981); U.S. TRADEMARK ASS'N, TRADEMARK MANAGEMENT: A GUIDE FOR EXECUTIVES (1981).

describe any similar product. For example, consider Scotch tape, which is made by the 3M Company, owner of the trademark "Scotch." In all company product literature, labels, and advertising, the tape is referred to as "Scotch brand tape." By putting "brand" after the trademark, one can tell that the trademark is the brand name of the product and not the product itself.

Another well-known mark in the United States is "Frigidaire," which was first used on refrigerators. To emphasize that Frigidaire is a brand name, it might be appropriate to refer to Frigidaire brand refrigerators, as opposed to other brands of refrigerators. Another indication that this trademark is a brand name is that it is used on a number of products, such as Frigidaire stoves, Frigidaire dishwashers, Frigidaire washing machines, and Frigidaire clothes driers. There are no frigidaire, but there is a Frigidaire refrigerator. Similarly, although "Hotpoint" was originally used on Hotpoint stoves, there are many other Hotpoint products, including Hotpoint refrigerators. One advantage of a mark like Hotpoint is that the general public will not normally refer to Hotpoints, but will refer to Hotpoint stoves.

When selecting a trademark, marketing and advertising people like to pick a mark that can be easily used generically. In contrast, a trademark lawyer prefers a mark which is a coined word devoid of meaning, like Kodak, which can be an extremely powerful mark. Even then, there may be a danger that people will refer to the camera as "a Kodak" rather than "a Kodak camera."

Different companies can use the same word as a trademark for different products, as long as the public will not think that the products are made by the same company.<sup>35</sup> For example, "Cadillac" automobiles and "Cadillac" cat food are made by different companies. In fact, the word "Cadillac" has been registered as a trademark or as part of a trademark by a number of business entities on a wide variety of products, including aluminum furniture, writing paper, binoculars, sausage, cheese, steel embossing marking dies, vacuum cleaners, and wine.<sup>36</sup>

With many products, and in licensing agreements involving them, a trademark may not have any significant value, particularly if the product is not sold directly to the consumer. In many cases where the product is sold directly to the consumer, however, the trademark is extremely valuable. For example, the trade secret involving the formula for Coca-Cola is a very valuable asset of the Coca-Cola Company. Nevertheless, the trade secret is not nearly as valuable to the company as is the trademark "Coca-Cola." If a company knew the trade secret for the Coca-Cola formula and could make an identical product, but had to sell it under the name "Blair's Cola," the company would have to spend a tre-

<sup>35</sup> See 3 R. CALLMAN, *supra* note 33, § 80.1 (3d ed. 1969).

<sup>36</sup> General Motors Corp. v. Cadillac Marine & Boat Co., 226 F. Supp. 716, 723-724 (W.D. Mich. 1964).

mendous amount of money on advertising, marketing, and publicity before its product would result in sales and profits. On the other hand, if a company could sell any brown-colored soft drink under the trademark Coca-Cola, it would immediately have large sales and would make a tremendous amount of money before the consumers decided that the rather ordinary soft drink did not taste as good as Coca-Cola. Even if the taste of the soft drink was only average, the company might still continue to sell large quantities of it under the Coca-Cola brand mark.

In most countries, a trademark registration can be renewed as many times as desired, particularly if the mark is still used.<sup>37</sup> This is the reason that proper trademark use is so important. If the trademark is lost, it is no longer owned by one enterprise, and anyone can use it. But if it is used properly and is still owned by the trademark owner, it may become well-known and very valuable over the years.

Trademarks, in one sense, are representative of quality. The trademark owner must make sure that any product sold with his or her trademark is of the appropriate quality. For this practical reason, as well as for legal reasons, quality control and inspection of products made under a trademark license are nearly always a requirement in the agreement. These requirements are not put in the license agreement so that the trademark owner can exert improper control over the trademark licensee. They are placed there, first, to protect the consumer by assuring him that the product is of a certain standard and has a certain quality, and, second, to protect the rights of the trademark owner in the trademark. If the owner does not control the quality of the product being sold under his trademark, the quality of the trademarked product will soon deteriorate and his trademark will lose its value. Furthermore, if the quality control mechanism is not required by the license agreement, in most countries, including the United States, the trademark will be lost.

A trademark does not prevent anyone from making any product. It merely prevents someone from identifying his product by using the same, or similar, brand name. In fact, if a competitor of a trademark owner made a product with better quality and properties than the product of the trademark owner, the competitor would not want to use a trademark of an inferior product but would prefer to develop his own trademark for his higher quality product. Thus, most of the copies made of brand names are inferior and are done in an effort to deceive the consumer.

As expressed in a United States federal district court decision,<sup>38</sup>

[A] trademark does not in any way represent a monopoly . . . upon a particular product . . . . While patent laws were enacted to encourage invention and development of new products, trademark laws were in-

<sup>37</sup> See 4 R. CALLMAN, *UNFAIR COMPETITION AND TRADEMARKS* 2166 (2d ed. 1950). See also N. HESSELTIRE, *A DIGEST OF THE LAW OF TRADEMARKS & UNFAIR TRADE* 106 (1906); A.H. SEIDEL, *WHAT THE GENERAL PRACTITIONER SHOULD KNOW ABOUT TRADEMARKS AND COPYRIGHTS* 26 (3d ed. 1976).

<sup>38</sup> *Car-Freshener Corp. v. Auto Aid Mfg. Corp.*, 438 F. Supp. 82 (N.D.N.Y. 1977).

tended solely to protect the consuming public from deception and confusion,<sup>39</sup> [which often results] from imitation of the distinguishing trademarks of established products.<sup>40</sup>

## V. Copyrights<sup>41</sup>

Copyrights are the other major proprietary asset involved in licensing. A copyright may be obtained on, among other things, writings, music, or works of art.<sup>42</sup> Copyrights have different properties from those of patents or trademarks. A copyright prevents someone from copying something; it does not prevent someone from using the same concept or idea. For example, if one person wrote a book about India, a second person could also write a book about India, which might discuss many of the same subjects as the first. If the method of expression and the particular details were different, there would be no copyright infringement problem and both authors could sell their books. A book written by a particular author in a particular style, however, cannot be copied until the copyright has expired and the book becomes available to all.<sup>43</sup> For example, the works of Mark Twain can now be published by anyone, because the copyrights have expired. On the other hand, there are many modern authors who still own and maintain their copyrights, and their books cannot be copied without their permission.

Important areas of copyrights relating to licensing are musical compositions, characters, such as those created by Walt Disney, movies, television programs, video games, and, a recent additional area, computer software.

## VI. Licensing of Proprietary Assets<sup>44</sup>

Licensing involves granting permission to use specific property in a given manner. Licensing proprietary assets, for example, means that an-

<sup>39</sup> *Id.* at 86.

<sup>40</sup> *Id.*

<sup>41</sup> For further information on copyrights, see H. HENN, *COPYRIGHT PRIMER* (1979); A. LATMAN, *THE COPYRIGHT LAW* (5th ed. 1979); M. NIMMER, *NIMMER ON COPYRIGHT* (1982).

<sup>42</sup> See J. MCFARLANE, *A PRACTICAL INTRODUCTION TO COPYRIGHT* 36 (1982).

<sup>43</sup> *G & C Merriam Co. v. Syndicate Publishing Co.*, 237 U.S. 618 (1915). See U.S. CONST. art. I, § 8; 17 U.S.C. §§ 101-810 (1982).

<sup>44</sup> For further information on licensing, see T. ARNOLD & T. SMEGAL, *TECHNOLOGY LICENSING* (1982); B. BRUNSVOLD, *LICENSING LAW HANDBOOK* (1981); L. ECKSTROM, *LICENSING IN FOREIGN AND DOMESTIC OPERATIONS* (3d ed. 1981); H. EINHORN, *PATENT LICENSING TRANSACTIONS* (1977); *THE LAW AND BUSINESS OF LICENSING* (R. Goldscheider & T. Arnold eds. 1982); Y. MATSUNAGA, *SUCCESSFUL LICENSING TO AND FROM JAPAN* (1977); H. MAYERS, *DRAFTING PATENT LICENSE AGREEMENTS WITH RELATED TREATMENT OF KNOW-HOW TRANSACTIONS* (1971); R. NORDHAUS, *PATENT LICENSE AGREEMENTS* (1976); U.S. TRADEMARK ASS'N, *TRADEMARK LICENSING: DOMESTIC-FOREIGN* (1962); *WORLD INTELLECTUAL PROPERTY ORGANIZATION, LICENSING GUIDE FOR DEVELOPING COUNTRIES* (1977). See generally *LES NOUVELLES*, a quarterly journal published by the Licensing Executives Society (L.E.S.). This is the only journal that deals solely with licensing and technology transfer. It is sent regularly to L.E.S. members and is available for subscription by governmental agencies or libraries through Mr. Jack Stuart Ott, 1225 Elbur Avenue, Cleveland, Ohio, 44107.

other person may use the licensor's inventions, product brand name, or copyrights. The business arrangement used to accomplish this is called a license or technology transfer agreement. The license agreement may include teaching the licensee how to use the inventions or the licensor's knowledge. It may be a one-time technology transfer or it may be ongoing, so that continuing technology improvements of the licensor are made available to the licensee.

Many people who are not involved in corporate licensing believe that corporations, particularly large ones, are nearly always the licensors in the license agreement and that the licensee is more likely to be a small company. That assumption is not always true. Most corporations have as many license agreements in which they are licensees as those in which they are licensors.

In the negotiation of a license, the size of the organization involved is not important. The real factors are the value of the technology, the strength of the other party's desire to use the technology, and the skill of the negotiators. It is not unusual for a small organization to be represented by someone who is more skillful and experienced in license negotiations than the person representing the large corporation. The number of people representing a multi-billion dollar organization in negotiations will be approximately the same as the number representing the small organization. Skilled licensing people are never overawed by the size of the organization on the other side. Moreover, the length of an agreement involving technology is approximately the same whether a few thousand or many millions of dollars are involved.

A licensor, in effect, tells the licensee that he will not sue him for infringing the licensor's patent. During negotiations, however, both parties must clearly understand the effect of both the particular patent being discussed and patents owned by others. For example, if the owner of the dial telephone patent licensed someone to make dial telephones, the license agreement should make very clear the situation with respect to the owner of the basic telephone patent. The rights of the parties should be set forth in the agreement so that the licensee understands that the licensor is not responsible for something the licensee might do under that license that could infringe the patents of others. Usually, the licensee merely gets the license (permission) from the licensor and conducts his own searches on the products that he makes to see whether they infringe the patents of others. Alternatively, the licensor may agree to help the licensee if patents owned by others are infringed by the licensee's actions. The latter responsibility may sometimes be satisfied by a royalty sharing arrangement. Again, this should be specified in the license agreement.

## PART TWO—*Why License?*

Licensing may be regarded as a middle approach between exporting and manufacturing. Licensing involves more work and commitment to

the foreign market than merely exporting, but involves less risk and fewer commitments than owning and managing manufacturing and distribution facilities, particularly overseas. Licensing may be seen as the process of exporting or importing proprietary assets rather than proprietary products. It is a form of investment without the use of dollars, and may provide a substantial return for the proprietary asset invested. Licensing may or may not be the best way to reach the objectives of a particular business.

## **I. Licensor's Viewpoint — Advantages of Licensing<sup>45</sup>**

### *A. Market Entry*

Licensing provides an entry into other markets without a large capital outlay. It also provides a mechanism to obtain rapid entry into a number of markets. While it may not be feasible to export or manufacture in many parts of the world, if a company is not at least represented the competition may rise up very quickly. Licensing may provide a technique of entering a number of markets in a very short period of time in various parts of the world. Furthermore, licensing may permit a company to penetrate domestic or foreign markets that are not readily available because of transportation costs, duties, government regulations, or customer preferences for local or long-term suppliers. Finally, licensing may be the only available avenue if neither direct exports nor a subsidiary or joint venture operation is feasible.

### *B. Royalties*

One of the major reasons for licensing is to obtain income. This income may be earned in a variety of ways. A single lump-sum payment or a lump-sum spread over a number of payments are common methods. Often there will be royalties based on sales with or without a substantial initial payment. The royalties may go on for a number of years and are a comparatively painless way for the licensee to pay the licensor. From the licensor's viewpoint, the royalty income may be spread over a substantial period of time to provide tax benefits.

### *C. Returns Other Than Royalties*

Licensing, of course, is not limited to a direct financial return in the form of royalties. It may be that in return for rights in the proprietary assets, the licensor will obtain an equity position in the licensee. In addition to obtaining the equity position, and thus a share of the profits, the licensor may also receive royalties on sales of the licensed item. The equity position, of course, has the same disadvantages that a joint venture may have. However, this risk may be well worth taking. The royalties

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<sup>45</sup> See generally Arnold, *supra* note 1, at 15-19.

may be invested in the licensee in return for equity, or accumulated and invested in other foreign markets.

#### *D. Effect of Licensing Upon Competition*

In practice, it is almost impossible to develop a technology that will put competitors out of business. Intelligent developers of technology often find it is preferable to make the technology available to others, particularly when they cannot handle the entire market by themselves. Thus, they are able to reap a return from the competitors. If the technology is not available to the competitors, the competitors may develop their own technology and avoid or break the patent of the originator if that is the only way for them to reach the market.

#### *E. Avoiding Build-Up of Unnecessary Capabilities*

Licensing may make it unnecessary to establish a permanent staff of administrative or technical personnel in a location that is not feasible. Also, it may be unnecessary to establish one's own marketing capability in an undesirable location due to the manufacturing or marketing capabilities of the licensee, who will usually be more familiar with the location involved.

#### *F. Access to Technology*

A license agreement may provide access to the technology of the licensee on either a cross-license or a license grant-back basis. Companies frequently license a number of organizations and include provisions wherein the licensees will grant a non-exclusive right back to the licensor, who will be permitted to pass the technology to his other licensees. Thus, all the licensees will have the advantage of the technological improvements of the licensor and the other licensees, so each may be able to provide the best products available. This also encourages disclosure between the organizations so each may have access to the other's developments.

#### *G. Testing*

A license may permit the licensor to test a product or process in another location where it cannot be done in the licensor's own location. For example, in the past, a number of building codes in United States locations would not permit the use of plastic pipe in houses. However, some United States plastic pipe organizations licensed plastic pipe technology to companies in other countries where there were no such regulations. Thus, the technology of actually using the pipe could be developed, and when the appropriate regulations were changed, a better product was available locally because of the improvements.

### *H. Military Licensing*

A very important category of licensing is that of granting a foreign company a license under part or all of the technology in a particular field. It may be necessary to include coproduction provisions in the agreement if the foreign government requires that a certain portion of the products involved be made locally. The licensor will gain royalty income and may also gain an export market for a portion of the needs of the foreign government.

### *I. Selling Related Items*

A license agreement may be useful in selling raw materials or associated products, services or equipment, but the provisions of the appropriate antitrust laws must be observed. Frequently, a licensee will not wish to make large quantities of spare parts and may be content to rely on the licensor for spare parts manufacture.

### *J. Other Advantages*

First, a license may be a useful technique in evaluating a licensee for additional licenses or possible partial or total acquisition. Working with an organization on a licensing basis is an excellent way to determine the characteristics and capabilities of the licensee organization without making a long term commitment. Second, licensing may provide benefits and income from technology that will no longer be used by the licensor but may be very useful in the territory of the licensee. The license may be a mechanism for providing services and supplies for distant customers of the licensor since the local licensee can take over this activity and give good service. A third advantage, which is particularly useful in trademark licensing, is that the value of the trademark will be increased by use of the trademark by the licensee. The goodwill of the trademark and its reputation will be enhanced after a number of years of use by the licensee, but the mark will still be owned by the licensor.

## **II. Licensor's Viewpoint — Disadvantages of Licensing<sup>46</sup>**

### *A. Income and Investment*

Usually, an organization can make more money by manufacturing and selling the product itself rather than by licensing. Royalties for a limited period may be an inadequate return for the licensor. Moreover, in manufacturing or exporting, a potential licensor can utilize or expand his own facilities and increase personnel and capabilities. The licensor will not build up his own market for additional or future products, and there may be insufficient opportunity for growth and investment.

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<sup>46</sup> See generally *id.* at 19-20.



*B. Lack of Interest*

Some companies have a limited interest in foreign markets and feel they have all the business they can handle in the United States. These companies do not wish to get involved in the complexities of licensing, particularly in the international field. The company may have its own methods of operating in international markets that do not involve licensing and that are appropriate for its own activities. The company, if a major exporter, may be able to compete very well by using the license. On the other hand, it may have decided to operate in the overseas market by the use of wholly owned subsidiaries and have no use for licensing.

*C. Control of Product*

Licensors may not be able to control the licensee's operations and because of this, the licensee may not make adequate use of the licensor's experience. This is particularly true if a trademark license is involved. If the licensor cannot adequately control the quality of the licensee's operations, an inferior product may result that damages the trademark itself and the licensor's reputation. Many licensors do not wish to take this risk, particularly when quality control is vital such as in a food product. If there is not adequate control, the trademark may actually be lost.

*D. Other Disadvantages*

Licensing may create a competitor who, by having access to the licensor's technology, will be better able to compete in the market in the future and may develop his own products. Also, providing adequate assistance to the licensee may be too burdensome, particularly if the licensee is quite inexperienced in the field, is located a considerable distance away, or is of a different culture and language.

**III. Licensee's Viewpoint — Advantages of Licensing<sup>47</sup>***A. Market Entry*

Licensing may permit rapid entry into a market using the completely developed and tested technology of others, thereby reducing risk substantially.

*B. Cost Reduction*

Taking a license from another is almost always cheaper and faster than developing one's own technology. The license may eliminate the need for extensive research since the research has already been done by another who has obtained known results.

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<sup>47</sup> See generally *id.* at 21-22.

### *C. Relationship with Licensor*

The license may provide management and marketing assistance in addition to technology assistance. The licensee may have access to technical services of the licensor and access to his problem-solving capability. The license may be the start of a much closer relationship, such as partial or total acquisition. In addition, the license may provide access to additional technology in other areas. Also, a license will give the licensee an opportunity to evaluate technology that he may wish to purchase for himself in order to license others.

## **IV. Licensee's Viewpoint — Disadvantages of Licensing**

### *A. Unsuitability*

The licensed technology may be unsuitable for the licensee's market. For example, it may be obsolete, the quality may be too high or too low, or the products licensed may be too expensive. Obviously, there must be a thorough investigation by the licensee before accepting a license. In this respect, if the technology is not adequate or is unsuitable for the licensee's market, the licensee may not be able to recover a down payment and must include the down payment as part of the loss.

### *B. Other Disadvantages*

First, the licensor may not be able or willing to render adequate technical assistance that may be necessary for the licensee to fully capitalize on the licensed technology. Second, the license may be too expensive or because of miscalculations or lack of thorough investigation, a profit on the licensee's operation under the licensed technology may be inadequate. Third, by accepting a license from one licensor, the licensee may have removed himself from access to other competitive licensors. If the licensee has chosen the wrong technology, he may not have the opportunity to license more desirable technology from others. And fourth, the licensee may also be harmed by unlicensed competition if the licensor's patent position is weak or if the licensor is not willing to take necessary steps to enforce his patent.

## **PART THREE—*The License Agreement***

### **I. General Comment**

Technology transfer or licensing may involve a wide variety of business arrangements. By and large, each technology transfer arrangement is a separate kind of business deal and there are no "form agreements" involved. Forms are used only if the same technology is going to be licensed to more than one company under the same terms. Standard clauses may sometimes be used, but more often than not particular situations require special clauses.

In negotiating licenses, a company must be careful to ensure that it

is represented by a licensing expert. Most lawyers know nothing about licensing, and even patent lawyers are not always skilled in this field, so hiring a lawyer may not be the best solution. It is always more difficult to negotiate a license agreement with nonexperts who do not know where they can and cannot be flexible during the negotiations. A representative who is not experienced in licensing cannot do a good job of protecting his client's interest while working out a reasonable business deal.

Those who are experienced in licensing have learned over the years that the only successful license deal is one that is good for both parties. Nothing is more bothersome than the lawyer who has one set of clauses and reasoning that he uses when his client is a licensor and a completely different set of clauses and reasoning which he uses when his client is a licensee. On most occasions, what is reasonable for the licensee is also reasonable for the licensor; therefore, a clause which is useful in a licensor situation often will be useful in a licensee situation. A licensing negotiation should be a reasonable discussion that works out the best business deal for both parties.

Often, negotiated contracts go into a lawyer's file and are not looked at again until problems arise. License agreements, however, are quite different. First, there must be a continual relationship in order to transfer the technology and make sure it is adequate for the licensee's use. Usually, there is a continual relationship that involves the payment of royalties. The royalties are not paid automatically, but are paid only after an appropriate system is set up so each party knows exactly what is being paid and why it is being paid.

The vast majority of license agreements result in improper royalties being paid because the payments are usually administered by accountants who do not understand the agreement and frequently do not even have it available. The product manufactured may change from time to time, and the trademarks may be changed as well. If the payment of the royalty is not properly administered, the payments often become inaccurate over a short period of time.

Choosing a licensing partner involves risk and, as in any partnership, one should retain as much freedom as possible to correct the situation if it is not working satisfactorily. Thus, a properly organized licensing program will provide for continual contact and will give the licensee the service and help it needs to be an effective operator and to return maximum amounts both to the licensee and to the licensor. The licensor must help the licensee as much as possible because the amount of money the licensor makes depends on how successful the licensee is. If the licensee is not successful, the licensor will not receive an adequate return.

## **II. Consideration — What to Charge? — What to Pay?**

In any good licensing agreement, both parties have to make money.

How much the licensor makes depends on what the licensee does, so there must be sufficient incentive for the licensee to do his best. One experienced in licensing realizes that since the licensee takes the major risk in the licensing venture, the licensee should receive a major share of the profit. The licensee must build a plant, buy equipment, spend money on manufacturing and marketing, and, if the project fails, take the loss. The licensor takes little, if any risk.

For good technology and a good proprietary position, a licensor should expect to receive royalties that approximate between fifteen percent and thirty-five percent of the licensee's profit estimate. However, it is dangerous to make the payment depend on a percentage of the profits. There are many definitions of profit, all of which involve sales less certain costs. Unless these items are defined in detail, arguments between the licensor and the licensee are likely to arise concerning how much can be included in the appropriate costs and what should be paid. Also, the licensee will not want the licensor to have full access to his accounting books and records in order to determine the costs or profits.<sup>48</sup>

The more common method, and by far the more desirable, is to pay a percentage of sales as the royalty. The percentage of profits, however, can still be used in negotiating to calculate the appropriate percentage of sales. For example, if the percentage of profits that is reasonable for the licensor to receive is about twenty-five percent, and the licensee estimates he will have a profit of twenty percent before taxes, it would be reasonable to charge a five percent (twenty-five percent of twenty percent) royalty on the net selling price.

Of course, royalties can come in a variety of formats. There can be a lump-sum royalty in a single payment, or a number of payments spread over a period of time. There can be a down payment plus running royalties. Part or all of the down payment can be charged against future running royalties. The running royalties can be a constant percentage of sales or a variable percentage of sales, increasing or decreasing with sales volume.<sup>49</sup>

It is also possible to charge a fixed amount of royalty per item. Again, this can be a constant amount per item or it can vary; an appropriate clause that will provide for an increase in the fixed amount per item as the sales price of the item increases may be necessary. Another way for the licensor to obtain value is to receive some equity in the licensee, which may be calculated as part or all of the royalties.<sup>50</sup>

Payment for the technology in the form of either part of the licensee's production or a completely unrelated commodity such as wheat or oil is often attractive to the Socialist countries, who are always short of hard currency. Even if the licensor cannot use the commodity itself, it

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<sup>48</sup> See Nordhaus, *supra* note 44, § 22.

<sup>49</sup> See *id.* § 20.

<sup>50</sup> See *id.* § 19.

can usually find a trader who will be happy to take it off the licensor's hands for a price.

### **III. Type of License**

The most common type of license is the "non-exclusive" license, whereby the licensor may grant licenses to a number of licensees. The licensee, however, may prefer an exclusive license or a license that is exclusive in certain territories or certain technical fields, because the licensee does not want the licensor to license the licensee's competitors. When negotiating an exclusive license, the licensor should always request some form of minimum royalty to ensure against inadequate performance by the licensee. If the minimum royalty is not met, the license will become non-exclusive or will terminate.

Another popular type of license is the "semi-exclusive" or "sole" license, whereby the licensee will not grant any licenses to others. The licensor, however, still has the right to make, use or sell the licensed item himself.

### **IV. Field Licenses**

A large proportion of the licenses to which Itek Corporation is a party are "field" licenses. These licenses are the type in which technology within a certain field is transferred and the licensee uses the technology only in that field. In the past, the Department of Justice spoke out against this type of license, but in more recent years its attitude has changed.

As a practical matter, it is often easier to define the technology involved by a field definition because technology may be useful in a wide variety of different fields that are not related. For example, a number of years ago, Itek developed technology for use in photographic processing. The technology was licensed to different companies in the microfilm field, the medical x-ray field, and the industrial photographic field. The equipment used to process x-rays is quite large because the normal medical x-ray film is over a foot wide. The equipment used to process microfilm, on the other hand, is quite different. The markets are different and the companies involved in these businesses had no interest in branching out into other areas of business. Each licensee, however, wanted an exclusive license in its field so that Itek would not license the competition.

The field definition is often the most important clause in the agreement. If it is not carefully drawn, the licensor may unduly limit itself. On the other hand, if it is not broad enough, the licensee will be too limited and will not be able to operate successfully in the field.

### **V. License Term**

Often, if a patent is involved in the license, the term of the license is the life of the patent. However, one must be careful in defining a term

based on the life of a patent. If there are a number of patents involved and the royalty continues until the last patent expires, there may be a violation of *Brulotte v. Thys*,<sup>51</sup> which held that a licensee cannot be required to pay royalties for acts performed after the licensed patent expires.<sup>52</sup> As the earlier patents expire, particularly if they are the more important patents, and the royalty is not adjusted downward, the licensee will be paying a royalty that is too high for the improvement patents still in effect. The licensor in effect has extended the life of the more important earlier expired patents.

Another important point to cover in the license agreement is maintenance fees. Under the laws of most foreign countries, and now under the law of the United States, if maintenance fees are not paid on the patents at the appropriate times, the patent will expire.<sup>53</sup> Thus, if a royalty rate depends on the life of the patent, and if the patent has expired because the maintenance fees have not been paid, no further royalty would be due. Rather than pay for the life of the patent, the royalty can be paid for a term of years that is negotiable and usually has a relationship to the useful life of the technology.

A trademark can be renewed periodically for an indefinite time.<sup>54</sup> Thus, a trademark license, if properly handled and the trademark properly used, may last for many years. As long as the licensee is still receiving benefits from the use of the trademark, he should continue to pay royalties.

The term of payment is a sensitive subject in many developing countries where governments feel that royalties should only be paid for a short time, such as five years. Any royalty payment after that is regarded as improper. A number of these countries require government approval, and their rules and regulations regarding the terms of the agreement are quite strict. Of course, if one has the only technology available, one is in a much better bargaining position on this point.

## VI. Territory

If patent rights are involved, the technology can be licensed to different entities in different countries or groups of countries. As mentioned previously, a U.S. patent is effective only in the United States.<sup>55</sup> Thus, a licensee in the United States can be licensed under the U.S. patent, another licensee in the U.K. under the U.K. patent, or another licensee in Japan under the Japanese patent. Also, one can license one company to make, use and sell in one country such as Germany, and not license them

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<sup>51</sup> 379 U.S. 29, *reh'g denied*, 379 U.S. 985 (1964).

<sup>52</sup> *Id.* at 32.

<sup>53</sup> 35 U.S.C. § 41(b) (Supp. V 1981).

<sup>54</sup> 15 U.S.C. § 1059 (1976). "Each registration may be renewed for periods of twenty years from the end of the expiring period upon payment of the prescribed fee and the filing of a verified application therefore . . . . *Id.*

<sup>55</sup> 35 U.S.C. § 154 (Supp. V 1981).

to manufacture in other common market countries. However, under European Economic Community (EEC) law, one can no longer exclude the manufacturer in one country from marketing in another country.<sup>56</sup> Thus, a number of manufacturers can be licensed in a number of EEC countries, but they will all be able to sell in any EEC country.

## VII. Sublicensing

If an exclusive or semi-exclusive license has been granted, the licensee may wish to have rights to sublicense others. Often, it is equitable to require that the licensee pay the licensor a percentage, such as twenty-five percent or thirty-five percent, of what he receives from the sublicensee. If the licensee is paying the licensor a royalty of five percent on sales and if he is required to pay a royalty of five percent of the sales of his sublicensee, there would be no incentive for him to license others, because he may not be able to license at a rate higher than five percent. Having the licensee pay the licensor a percentage of what he receives from sublicenses gives him an incentive to sublicense others. Thus, the licensor may be able to obtain a reasonable return from the sublicensing activities of his licensee.

## VIII. Indemnification

### A. Patent Infringement

Since a patent does not give the patent owner the right to actually make, use or sell the product, a license under a patent does not give the licensee a positive right to make, use or sell the licensed product. The license means that the patent owner will not sue the licensee for infringement of his patent. Thus, when deciding to take a license, the licensee must take into consideration patents owned by others and what his liability will be if he infringes those patents.

A licensor does not normally indemnify the licensee if the licensee infringes patents owned by others when using the licensed technology or patent rights. While this may seem unfair, there are a number of valid reasons for it. First, a licensor normally has no control over the licensee. If the licensor fully indemnified the licensee against the patents of others, there would be no incentive for the licensee to change his design in accordance with the licensor's suggestion to avoid the patents of others. Second, the licensee is making the most profit on the license. If the licensee were paying three percent royalty to the licensor and had to pay five percent royalty to another, the licensor, if he indemnified the licensee, would have a net outflow of two percent with no return from his license.

In certain circumstances, the licensee and licensor can negotiate a

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<sup>56</sup> See P. DEMARET, *PATENTS, TERRITORIAL RESTRICTIONS AND EEC LAW* (1978); B. HAWK, *UNITED STATES, COMMON MARKET, AND INTERNATIONAL ANTITRUST: A COMPARATIVE GUIDE* (1982).

sharing of royalty payments made to others. While this agreement does not completely indemnify the licensee, it does provide some relief. On occasion, legal expenses of the licensee spent in investigating the patent situation or in fighting a patent infringement suit will be among the costs that are shared in this manner.

In many developing countries, and some parts of the United States, the licensor is required to guarantee that the licensee will not infringe the patents of others. This may put the licensor in such a position that he may not wish to transfer the technology because the risk is too great.

### *B. Liability to Customers of Licensee under Patent or Trademark Licenses*

No law or judicial opinion in the U.S. holds the patent licensor liable for injuries caused by a product made by a licensee under the patent. On the other hand, the courts point out that the trademark licensor controls the quality of the product being manufactured under the trademark license and benefits from the trademark license. Therefore, the trademark licensor will be strictly liable for injuries or property damages caused by defective products made by the trademark licensee.<sup>57</sup> Sections 5<sup>58</sup> and 45<sup>59</sup> of the Lanham Act require that a trademark licensor in the United States control the quality of a product manufactured by his trademark licensee. If not, the licensor is in danger of losing the trademark.<sup>60</sup> Thus, the trademark licensors have a problem. If there is no control on the licensed goods, they may lose their trademark. If there is adequate control, they will be strictly liable for defective products turned out by their licensee.<sup>61</sup> There are four possible solutions to this problem:<sup>62</sup>

1. Include clauses in the trademark license that exempt the licensor from any liability on products made by the licensee except for those

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<sup>57</sup> It is well established that the licensor of a registered trademark owes a duty to the public to monitor the quality of parts sold by its licensed dealers. *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 51 (9th Cir. 1971). For a licensor, through relaxation of quality control, to permit inferior products to be presented to the public might well constitute a misuse of the mark. *McAlpine v. Aamco Automatic Transmissions, Inc.*, 461 F. Supp. 1232, 1240 (E.D. Mich. 1978). See Lanham Trade-Mark Act, §§ 5, 47 (codified at 15 U.S.C. §§ 1055, 1127 (1976)).

<sup>58</sup> 15 U.S.C. § 1055 (1976).

<sup>59</sup> *Id.* § 1127.

<sup>60</sup> See 1 J. GILSON, TRADEMARK PROTECTION AND PRACTICE 6-7 (1976).

[The] moment (the trademark owner) permits someone else to use his trademark, the trademark laws and overriding public interest impose a new obligation on him with respect to quality. He must control the nature and quality of the goods or services sold under the mark by the licensee, and he must at all costs avoid deceiving the public. The fact that he may decide for business reasons to license his mark to a thousand or more licensees does not diminish this obligation in the least. The problem of control increases greatly with increasing numbers of licensees, but the licensor must fulfill his legal duty to the public nonetheless.

<sup>61</sup> For a discussion of the product liability of the trademark licensee, see Blair, *Product Liability and Trademark Licensing — Hoisted by His Own Petard?*, in RECENT DEVELOPMENTS IN LICENSING 220-29 (A.B.A. Patent, Trademark, and Copyright Law Section 1981).

<sup>62</sup> *Id.*



relating to trademark rights. Disadvantages to this are that some countries will not permit such clauses, and such clauses are ineffective if the trademark licensee is judgment-proof.

2. Require the licensee to obtain insurance that names the licensor as co-insured.

3. Require the trademark licensor to "self-insure."

4. No longer grant trademark licenses.

Obviously, the first two suggestions are the best, and both should be attempted.

## IX. Bankruptcy

Most license agreements in the past contained clauses to the effect that the license terminated if the licensee went bankrupt or appointed a trustee or receiver. Many license agreements still include these clauses, but, unfortunately, the Bankruptcy Reform Act of 1978<sup>63</sup> obliterated all such clauses as of October 1, 1979.<sup>64</sup> Under bankruptcy law at present the state of the law is unclear. Dent and Arnold recommend that the retention and protection of a security interest is probably the best way to handle the bankruptcy of licensees and they discuss this in some detail.<sup>65</sup>

## X. Conclusion

There are a number of other clauses which frequently appear in license agreements but, as pointed out above, each agreement is a particular business deal and they rarely are alike.

One of the best comments on negotiating and drafting a license agreement appears in an article by Tom Arnold,<sup>66</sup> where he states:

[T]he various clause concepts are as keys upon a piano. Each many be played loudly, softly, staccato or with lingering resonance; and each may be played in solo melody or in chords with the others in infinite variety; they constitute a piano upon which infinite varieties of transactions can be played. And the playing of them well requires some careful attention to the skills and strategies of negotiation . . . . For the man with imagination to figure out and use both his own and his potential partner's legitimate needs and greeds, and to figure out how to satisfy them on both sides, will produce good contracts whereas others will fail. And often times, it is the burdens of your own side's restraints that are harder to work with than those of the negotiator.

<sup>63</sup> Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified in scattered sections of 11 U.S.C.).

<sup>64</sup> For a discussion of bankruptcy termination clauses in licensing agreements, see Dent & Arnold, *Changes in Bankruptcy Law Important to Licensing*, in RECENT DEVELOPMENTS IN LICENSING, *supra* note 61, at 63-85.

<sup>65</sup> *Id.*

<sup>66</sup> Arnold, *Basic Considerations in Licensing*, in RECENT DEVELOPMENTS IN LICENSING, *supra* note 61, at 6-22.