KEY ASPECTS OF IP LICENSE AGREEMENTS

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1. Defining Intellectual Property Rights

Intellectual property rights are intangible rights. Unlike other personal property rights, they cannot be touched, or seen. For example, a copy of a book is a personal asset that is easily viewed and identified. Copyright does not prevent you from reading the book, or giving your copy of the book to another person. But the copyright does protect the expression of the words and ideas in the book, and it is that expression that is protected, not the physical copy of the book itself.

In order to properly draft and negotiate license agreements, it is important to understand the nature of the intellectual property rights being licensed. Different intellectual property rights will require different language in the grant of the license agreement. This is particularly true when multimedia products, which may incorporate several different types of intellectual property rights, are being licensed. The nature of the intellectual property right being licensed may also affect other provisions of the agreement, such as the length of term of the agreement.

Most intellectual property rights are created by statute; they exist as a result of legislation which both defines and limits the scope of protection afforded to the intellectual property right. They may be territorial in nature (e.g., a U.S. patent is only valid and enforceable in the U.S.), or international (e.g., copyright in a book authored by a Canadian will be valid in all countries that are parties to the Berne Convention). They may be time-limited (e.g. a Canadian patent is currently valid for a period of 20 years from the date the application for the patent was filed) or perpetual, subject to conditions (as long as a trade-mark is used in a manner that doesn’t render it generic, the trade-mark right will continue to exist).

Two general classes of intellectual property rights exist: so-called “hard” intellectual property rights (including patents, trade-marks and copyright) and “soft” intellectual property rights (including confidential information, trade secrets and know-how).

(a) Patents

A patent gives the owner the exclusive right to manufacture, use and sell the invention claimed in the patent, and the ability to prevent others from doing the same. Of all of the intellectual property rights, patents grant the most exclusivity and the greatest amount of protection in respect of the patented invention. A patent will protect the ideas embodied in the claimed invention, and not just the expression of it. Even if you independently develop the same invention on your own, without any knowledge of the patent, you can still be barred from making, using or selling your invention until the patent that claims it has expired.

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Because of the breadth of exclusivity afforded to patent holders, patents are more difficult to obtain than other forms of intellectual property rights. A Canadian patent must be issued by the Canadian Intellectual Property Office. In order to be issued a patent, the invention must meet all four of the following requirements:

(i) **Patentable Subject Matter**: any new and useful art, process, machine, manufacture or composition of matter, or improvement, can be the subject of a patent. Scientific principles, mathematical equations and other like “inventions” are not patentable subject matter. As a result, in Canada, computer software programs that are purely algorithmic expressions may not be patented; however, some patents have been obtained on inventions where the software component is combined with some other non-algorithmic invention.

(ii) **Novelty**: the invention must not have been disclosed in a manner such that that it had become available to the public prior to the filing date of the application (if the disclosure was by a third party), or prior to one year before the filing date of the application (if the disclosure was by the inventor).

(iii) **Non-Obviousness**: the invention must reflect some amount of inventive ingenuity; in other words, it must not be obvious to a skilled professional in the art, having regard to all of the other information and prior art available to him or her.

(iv) **Utility**: the invention must serve some functional purpose and it must deliver the results promised in the patent, if any.

The term of a patent, i.e. the length of time during which the patentee is able to exercise its exclusive rights, is currently twenty years from the Canadian application date. A patent is acquired by filing an application with discloses the invention sufficiently and sets out in the claims the precise invention that will be protected. Because patents eventually become public documents, some corporations may choose not to disclose the inventions and maintain the invention instead as a trade secret.

(b) **Trade-marks**

Trade-marks rights, if registered, give the owner the exclusive right to the use of the trade-mark in Canada in respect of the wares and services associated with it, and the right to prevent others from using the same or confusingly similar marks. A trade-mark may be a word or combination of words, designs, symbols, colours, fragrances or the “get-up” of a package or product.
Trade-mark rights do not necessarily have to be registered, as the right itself is acquired through use of the trade-mark that designates the source of origin of goods and/or services with which the trade-mark is associated. Owners of unregistered trade-mark rights can prevent a third party from using their trade-marks, but only if they can establish that the third party is attempting to deceive the public by “passing-off” its goods and/or services as those of the trade-mark owner.

Trade-mark registrations may be renewed indefinitely subject to the continued use of the mark. Failure to use the trade-mark may expose a trade-mark owner to an expungement proceeding which, if successful, would result in the removal of the mark from the registry. It is also possible to lose a trade-mark right if the distinctiveness of the mark is lost and it becomes “generic”. Examples of trade-marks that have become generic in some jurisdictions include THERMOS, ASPIRIN and MARGARINE. It is incumbent on a trade-mark owner to police infringements of its trade-mark rights and enforce those rights to avoid losing distinctiveness of the mark.

(c) Copyright

Copyright gives its owner the sole right to produce or reproduce the protected work. Copyright can subsist in any original literary, artistic, musical or dramatic work, or any substantial part thereof, in any material form whatever. The copyright arises automatically upon creation of the work – no registration is required, although registration does offer some limited presumptions of validity in the event of litigation. Copyright offers a far more limited scope of protection than a patent, because it protects the expression of the original work, but not the underlying ideas. As long as there is no actual copying involved, anyone can produce a similar work even if they are using the same underlying ideas.

Under copyright law, there are a number of related and more specific rights, including the right to:

- perform the work in public;
- publish the work, if it is unpublished;
- produce, reproduce, perform or publish any translation of the work;
- convert a dramatic work into a novel or other non-dramatic work;
- convert any non-dramatic work into a dramatic work by way of performance in public or otherwise;
- make a sound recording, cinematograph film or other contrivance by means of which a literary, dramatic or musical work can be mechanically reproduced or performed;
- reproduce, adapt or publicly present any work as a cinematographic film;
- communicate a work to the public by way of telecommunication
- publicly exhibit, for a purpose other than sale or hire, any artistic work created after June 7, 1988 other than maps, charts, or plans;
- rent a copiable computer program or sound recording (for musical works); and
- authorize any of the above acts

Any of the above rights may be licensed individually or as a bundle of rights granted to a licensee.

Copyright law also recognizes moral rights accorded to original authors of protected works. Moral rights may not be assigned, and can only be waived. Moral rights enable authors to protect the integrity of the work.

In Canada, copyright generally subsists for the life of the author plus 50 years but there are exceptions depending on the type of work and whether it was authored by one or more persons.

(d) “Soft IP Rights”

“Soft” intellectual property rights usually refer to a category of rights that are not protected by legislation (as is the case for patents, trade-marks, copyrights and others) but nonetheless fall into the category of “intangible” rights and are usually associated with other intellectual property rights. These rights include know-how, trade secrets and confidential information.

The terms “confidential information”, “proprietary information” and “trade secrets” are often used interchangeably, however the courts’ interpretation of those terms have noted distinctions. A trade secret is considered to be information that is actually secret in an objective sense. For example, the recipe for Coca Cola and the recipe for Kentucky Fried Chicken are actual trade secrets, unknown to anyone other than the companies that own the products and their employees.

Confidential or proprietary information, on the other hand, may not necessarily be known only to the owner of it – it may be a compilation of information that has been collected by a company through the expenditure of time and resources, and therefore it has value without being inherently “secret”. Because it has value, the circulation of that information would deprive the owner of it with the benefit of having collected it. Examples of confidential information include customer lists, databases and certain know-how.
While courts may acknowledge the existence and value of confidential information and trade secrets, confidential information is not usually considered to be property in the same way as other intellectual property rights. The only practical way to preserve the value of that information is through the enforcement of contractual obligations or obligations of good faith arising from a relationship.

The benefit of maintaining a trade secret is that it does not expire; the right preserves its value for so long as the information remains confidential, and therefore the period of exclusivity may be indefinite. However, once the information becomes public, the trade secret loses all of its value. Even though the trade secret owner may have a right of recourse against a third party who, though wrongful actions, disclosed the trade secret, that may not compensate for the loss in value, and innocent parties who receive the information may be free to exploit it without sanction. It is, therefore, the most tenuous of intellectual property rights.

Know-how may be a subset of trade secrets or confidential information. It is often licensed concurrently with patent rights – the patent disclosure, while sufficient to describe the invention claimed, may not include other technical information that may be valuable to a licensee in exploiting the invention, such as information relating to the optimum commercial exploitation of a technology. This additional technical information is referred to as know-how.
2. **Skeleton of a License Agreement**

Every License Agreement should contain a framework - a skeleton - which provides support for other clauses or systems of clauses in the License Agreement. Sometimes these skeletal elements are scattered throughout the Agreement and, due to awkward drafting, can be difficult to find.

The skeleton of a License Agreement is:

- Identification of the Parties
- Recitals
- Definitions
- License Grant
- Compensation
- Obligations of the Parties
- Term and Termination
- Conflict Resolution
- Other Common Clauses

Each of the above is discussed more fully below.

(a) **Identification of the Parties**

Although self-evident, the Agreement should be made between the party who has the right to grant the license and the party who will be exercising that license. Additional details, including the addresses for each of the parties, the jurisdiction of incorporation (for corporate entities) and the effective date of the Agreement, may also be included in the identification section of the Agreement.

It is important to ensure that the full legal names of the parties are used to identify the parties. Only the parties that actually sign the Agreement will be legally bound to its provisions; if there is some concern about a “shell” corporation being the only one responsible to fulfil obligations or provide indemnities, it may be worth considering adding the parent company to the Agreement as a guarantor.
It is also helpful to consider using shorthand terms such as “Licensor” and “Licensee” to simplify the drafting the Agreement. But be careful – if there are more than two parties, the use of “Licensor” and “Licensee” may become confusing, especially if cross licenses are involved. It may be preferable to use shorthand terms that are more unique, to avoid confusion when drafting and reviewing the Agreement: for example, “ABC Company (Canada) Incorporated” could be shortened to “ABC Canada”.

(b) **Recitals**

The recitals tell the “story” of the parties and their relationship up to the time of the Agreement. For example, if the parties are entering into a license agreement as part of a settlement to an infringement action, the recitals can lay out the sequence of events leading up to the settlement. If the intellectual property rights that are the subject of the license were assigned or transferred, and the license is intended only to assist the seller in transitioning its business, this can also be set out in the recitals.

Properly drafted recitals can be very useful tools in explaining the context and background of the license to a reader, and can assist in the interpretation of the Agreement. It is important, however, to ensure that there is nothing in the recitals that is inconsistent with the main provisions of the Agreement. The final clause of the recitals typically makes it clear that the binding obligations of the parties are set forth in the main body of the agreement, and not in the recitals.

(c) **Definitions**

The definition clause is the dictionary for the Agreement. The parties to the Agreement can define terms like "licensed patents", "use" and "royalty" to make clear the rights and obligations of the Agreement. The definitions can be used to simplify drafting; for example, if a series or family of patents is being licensed, the full list can be scheduled and then captured by the defined term “licensed patents”.

Definitions can also be used to limit the scope of the license; a definition of “field” may clearly set out the limits on the licensee’s rights. Similarly, the definition of “revenue” or “net revenue” may impact the amounts of royalties to be paid to the licensor. It is important to note that if a word or terms are defined in the Agreement, the defined meaning will take precedence over any other common meaning for the word or terms.

(d) **License Grant**

The license grant provision is one of the most critical elements of the Agreement. It sets out the scope and extent of the rights granted to the licensee, as well as any limitations on those rights.
(e) **Compensation**

The provisions dealing with compensation set forth the consideration that the licensee is expected to pay to the licensor in exchange for the license rights granted to it. The compensation provisions of the Agreement may deal with the amount of compensation owing to the licensor, the timing and frequency of payments, liability for taxes and often include details on any reports that the licensee must provide to the licensor with payments.

(f) **Obligations of the Parties**

Depending on the type and complexity of the Agreement, each of the licensee and licensor may have specific obligations that must be fulfilled during the term of the Agreement and even beyond the expiry or termination of the Agreement. These obligations may range from positive obligations such as a duty to report infringement, to negative obligations such as a duty not to compete with the licensor. It is imperative that the obligations of the parties be clear and unambiguous; if they are too vague, it may make it difficult for a party to terminate the Agreement without liability for a failure of one party to fulfill its obligations.

(g) **Term and Termination**

As with any type of commercial agreement, a license agreement should have both a defined term and provisions outlining when a party may terminate the agreement, and for what reason. It is also recommended to deal with the effect of termination in advance, so that each party can plan an exit strategy with full knowledge of the consequences of any termination of the Agreement.

(h) **Conflict Resolution**

Intellectual property disputes can be extremely costly, even if they arise in the context of a license arrangement. Most license agreements include provisions that attempt to regulate the manner in which disputes between the parties may be resolved, in an effort to ensure that costs are contained.

(i) **Other Common Clauses**

The remainder of the skeleton of the Agreement will include other clauses that are common in a license agreement. These may include representations and warranties, provisions that govern the treatment of confidential information, and standard legal “boilerplate”.

3. **Grant of Rights**

The grant clause is the most important clause in any intellectual property license agreement. It specifies "who gets what". For example, a grant clause could be as simple as "the Licensor hereby grants to the Licensee a license to Use the Software in the Territory for the Term of this Agreement". Recourse may be necessary to the definitions clause in order to find out the meaning of the capitalized terms. Alternatively, the grant clause could be far more comprehensive, providing the licensee with the right to be the only person entitled to exploit a patented invention, or market a product using a trade-mark.

The object of the grant clause is to grant permission to the licensee to use certain intellectual property rights of the licensor.

Care must be exercised by the licensor that the grant clause does not grant "all right, title and interest in and to the intellectual property" to the licensee. Such a clause would constitute an "assignment" of the intellectual property rights making the purported licensee the new owner of these rights, even to the exclusion of the purported licensor.

(a) **Degrees of Exclusivity**

The licensor can grant to the licensee a license of varying scope. A license may be: exclusive, sole or non-exclusive.

(i) **Exclusive License**: The broadest scope of license that can be granted is an "exclusive" license. From its root in the word "exclude", an exclusive license excludes the use of the intellectual property right licensed to everyone but the licensee. After granting an exclusive license, the licensor is excluded from continuing to use the intellectual property. The grant of an exclusive license is as close as one can come to assigning the intellectual property right. The licensor retains ownership but licenses away everything else.

(ii) **Sole License**: A "sole" license, once granted, prevents the licensor from licensing the intellectual property to anyone else. The licensor retains the right to use the intellectual property.

(iii) **Non-Exclusive License**: A "non-exclusive" license can be granted as often by the licensor to as many licensees as desired. Most commercial software licensed today is licensed on a non-exclusive basis.
(b) **Sublicenses**

In addition to the types of license discussed above, a grant may include the right of the licensee to "sublicense" the intellectual property rights granted to it. The sublicense may encompass all or only a portion of the rights granted to the licensee. For example, a licensee may be granted the right to use, copy and modify source code, and to sell the resulting software product in object code. It may in turn be granted the right to sublicense the right to sell the software product (through distribution channels or sales agents), but not the right to sublicense its right to modify to the source code.

A licensor will want to be particularly cautious about sublicenses of any trade secrets (in the above example, the source code could be considered a trade secret), as direct control of the intellectual property right is one party “removed” in a sublicense arrangement. If a sublicense right is granted, it is common for the Agreement to include a provision allowing the licensor to approve the terms and conditions of any sublicense, or at the very least to require that the sublicense be on terms and conditions that are substantially the same as those set forth in the Agreement. This is particularly critical when trade-marks are sublicensed, as it is necessary for the trade-mark owner to ensure that the use of any licensed marks are monitored and quality standards are imposed on any products or services bearing the licensed marks.

Sublicensees may either pay royalties or other license fees directly to the licensor, or to the licensee who would then share the royalties or other license fees with the licensor on an agreed-to basis.

A grant is usually personal to the licensee. Therefore, any rights granted may only be exercised by the named licensee in the Agreement. Sometimes a licensee knows ahead of time that its subsidiaries or affiliates will need to be able to exercise license rights on behalf of the licensee or for their own account – for example, it may be more cost-effective for a licensee’s foreign affiliate to manufacture licensed products which would then be sold by the licensee. As another example, tax or other legal considerations in certain jurisdictions may necessitate the establishment of a local entity for distribution. If these are concerns, the licensee should ensure that it either has a right to sublicense, or that the grant is expanded to include subsidiaries and affiliates of the licensee.

(c) **Scope of Grant**

The scope of the actual grant will depend on the type of intellectual property licensed. It may also depend on the commercial deal struck by the parties. The scope of the grant may well be less than the full range of rights afforded to the owner of the intellectual property. Some examples of the types of limitations on the scope of the grant include:
(i) **Nature of the intellectual property:** The nature of the intellectual property will dictate the scope of the rights granted under the Agreement. A licensor can only part with those rights that it itself holds – therefore the license of a patent is typically limited to any or all of the right to make, use and sell the patented invention. A license grant under a copyright could include any of the many subsidiary and derivative rights accorded to the copyright owner.

(ii) **All or part of the rights:** A patent licensee may be granted the right to use the patented technology, or to manufacture and sell a product embodying or incorporating the technology, or any other combination of rights. If the commercial relationship is one of franchisor-franchisee, the license grant will likely focus on trademarks, and will ordinarily be limited to a right to “use” in association with specified products. If software is being developed and licensed, then the license grant may include the right simply to use, or perhaps a right to use and modify if the licensee intends to customize the software. The variations are limitless, and each grant must be carefully crafted so that it is tailored to the business arrangement contemplated by the parties. It is important that the licensor does not part with more rights than it needs to, but equally important that the licensee is empowered with the rights it requires to fulfil its business objective.

(iii) **Field:** Field of use restrictions in the grant are another way in which intellectual property rights may be “parcelled” by the owner. A “field of use” limitation may limit the grant of a technology with general or broad application to a narrow and defined product, use or purpose. If a party owns a patent on a drug product that has been approved for several therapeutic indications, a licensee may be entitled to use, manufacture and sell the product, but only for the treatment of one approved indication, or for the sole purpose of research in a specific area. Field of use restrictions may also operate to limit a license to the production of a specific style or size of product, or to the use of a mark in association with services provided to a specific market segment. Field of use limitations are particularly common in software licenses, where use of the software (and by extension, the intellectual property rights associated with the software) may be limited to a particular machine or work station, or limited to use in association with a particular product.

(iv) **Territory:** Territorial limitations are extremely common, particularly in the area of trade-mark licenses where different distribution partners may be granted exclusivity for their regions. The territory may be as broad as “world-wide”, limited to a particular province or region, or even as restricted as a plant location.
(v) **Release:** If a license is being entered into as part of a settlement to infringement proceedings, it may be necessary to include in the grant section a release against infringement that was alleged to occur prior to the date of the Agreement. Although most properly drafted grant provisions will make it clear that the rights granted to the licensee are conditional upon the licensee’s compliance with its obligations under the Agreement, this is particularly important in a release-type grant if the licensor intends to retain the right to recover damages for the past infringements upon any future breach by the licensee of the Agreement. This would likely only apply where specific consideration for the release has not been provided.

(d) **Implied Rights and other Restrictions**

Certain types of intellectual property license grants necessarily involve the grant of implied rights. For example, a computer program is "used" when it executes to provide the desired result. The computer program is typically stored in permanent memory and copied to the Random Access Memory of the computer while individual steps of the program "execute". Arguably, this is a copying of the program from the hard drive to the RAM. Thus a license to "use" a computer program implies that a license has been granted to copy the computer program to the extent necessary to allow the computer program to execute. This does not mean that the computer program can be copied so as to be modified by the licensee. Such a permission would have to be either expressly granted or be implied from other terms in the license.

Some drafters include clauses to specify what the grant did not include, couched as “other restrictions”. This can be drafting overkill, since whatever is outside the grant clause is not granted. However, including a list of what the licensee cannot do may serve a useful purpose of reminding the licensee of what cannot be done.
4. **Negotiating the Appropriate Compensation**

Every contract must have "consideration": something valuable flowing between the parties.

Usually, the consideration paid by the licensee to the licensor is some form of royalty payment. Sometimes the licensee grants back to the licensor ownership of improvements or a right to use technology owned by the licensee. In an intellectual property license agreement, the consideration to the Agreement brought by the licensor is the right to use the intellectual property. The consideration of the licensee is the payment of a fee or other consideration in exchange for the license grant. The method of payment of the fee is limited only by the imagination of the parties.

(a) **Royalties and License Fees**

Most licensors want some form of lump sum payment at the commencement of the license. Sometimes this is the only consideration paid by the licensee, as in the case of a fully paid-up, perpetual license or the purchase of shrink-wrapped software. Often, if there are to be continuing payments, it is known as the "initial license fee" or "upfront license fee".

The licensor may also require continuous periodic fee payments (sometimes called "royalties") which are paid on any regular basis (monthly or annually). These monies provide a continuous stream of revenue that the licensor can use to pay for further development of intellectual property or attribute as profit from the development of the intellectual property. Royalty amounts may be fixed ($X per year) or variable (X% per unit sold). The Agreement may also provide for the licensee’s ability to recoup the upfront license fee by delaying payment of royalties until such time as the royalties payable are equal to some portion of the upfront license fee paid. Parties need to be careful about drafting these types of provisions to avoid inadvertently creating a ‘deposit’ or ‘advance’ when none is intended.

Even if the royalty amount is fixed, in order to recognize the increases in the licensor's operating costs, the Agreement may contemplate an incremental increase in the annual fee based either on inflation or an inflation index such as the Consumer Price Index.

The fees paid by the licensee may also be triggered by specific milestones in lieu of annual, quarterly or monthly dates. For example, if the commercial viability of a licensed product is dependent on regulatory approval, royalties could be made payable at each stage in the regulatory approval process. The licensee isn’t required to pay unless it can make commercial use of the intellectual property, while the licensor can demand higher royalties for each additional regulatory stage, thereby sharing appropriately in the success of the licensee.
However, a licensor may want more certainty of revenue and may elect to include both milestone fees and annual fees based on use, irregardless of the commercialization process, particularly when the licensee has obtained exclusive rights to the intellectual property.

Variable royalties typically tie into sales of products sold by the licensee that use or incorporate the licensor’s intellectual property. They may be expressed as a percentage of revenue, or as a fixed amount per unit sold. Royalties may also vary depending on whether a product sold is “covered” by an existing claim in a patent, or merely covered by know-how; typically, the “know-how” royalty is a fraction of the “patent” royalty. Variable royalties usually vary in direct proportion to some parameter indicative of volume; they may be scaled back or increased as the volume increases. They may also be scaled back or increased as a function of time – if the half-life of the technology is small, there may be far more value to the exploitation of the intellectual property during the early part of the term of the Agreement, and far less as time goes by and competitors are able to invent work-around solutions.

(b) Negotiating a “Reasonable Royalty”

A reasonable royalty is generally defined as the amount that a willing, arms’ length party would be willing to pay for the right to the intellectual property. In intellectual property infringement actions, courts often attempt to determine this amount in order to assess damages owing to a right holder for past infringement. The highest possible royalty is not necessarily the most advantageous for a licensor if it acts as a disincentive to the licensee to fully exploit the technology.

The following factors may be considered when determining what a reasonable royalty rate would be:

- Prevailing royalty rates in the business or industry on similar technology (ballpark range).
- Research and development costs in developing the technology.
- Capital costs of licensee to implement.
- Nature of technology (i.e. breakthrough or improvement) and state of technology (i.e. prototype or proven).
- Cost, risk and delay in litigating.
- Nature of rights granted (e.g. exclusive vs. non-exclusive, field of use restrictions, bare patent license vs. know-how).
- Expected market penetration and volumes.
- Method of payment (e.g. upfront royalty vs. running royalty).
(c) “Most Favoured Nations” Clause

To protect the competitive advantage afforded to the licensee by the Agreement (i.e. the licensee's use of the technology), the licensee may wish to include a ‘most favoured nation's clause’ in the license agreement. This provision purports to assure the licensee that it will, at all times, be paying a royalty rate to the licensor that is at least as favourable to it as any other licensee.

The clause generally provides that the licensor will notify the licensee of the royalty terms of any other license it may grant in the future and if such terms are deemed by the licensee to be more favourable than those accorded to it, it may opt for such other terms in their entirety. However, qualifiers are often introduced by the licensor. For example, the licensor may attempt to limit the provision to other licenses on ‘substantially the same terms and conditions’ or under ‘substantially similar circumstances’. This will allow the licensor to negotiate lower royalty rates in exchange for other consideration (such as volume commitments, or a specialized field of use) without being in breach of its obligations to the first licensee.

(d) Basis for Royalty Calculation

If the royalty is tied to revenues or sales, it is usually expressed as a percentage of a defined monetary amount – for example, 5% of “Net Revenues”, or 10% of “Gross Profit”. It is ultimately up to the parties to define these amounts and agree on an acceptable basis for royalty calculation.

Care should be taken when defining terms such as “Net Revenue”. Typical deductions may include shipping and packaging charges, taxes, returns, rebates, allowances for bad debts and other items. Each deduction will have the effect of lowering the Net Revenue amount, thereby lowering the royalties payable by the licensee. The parties may spend more time negotiating the definition of “Net Revenue” or other term than in negotiating the quantum percent of the royalty.

Taxes in an intellectual property license arrangement must also be considered, quite apart from the issue of whether or not they are deductible from a definition of net revenue. It should be made clear in the Agreement who is to absorb and pay relevant taxes, including any applicable sales, customs and excise, or withholding taxes. Withholding taxes are of particular concern in international licensing arrangements. If one party is obligated to assume responsibility for withholding taxes, the Agreement usually includes a provision which requires the other party to provide reasonable assistance in respect of any possible refunds.
(e) **Minimums and Maximums**

One advantage of tying a royalty into revenues is that it precludes the need for a separate consideration of inflation. However, if the product is comprised of several technologies, each of which accounts for some portion of the expected revenue, a licensee may view an attempt by a licensor to ride the “coattails” of a successful product as unfair. This may be the case when the licensee has developed several improvements to the technology which, over time, are largely responsible for a higher selling price. Although far more administratively complicated, it is possible to tie the definition of revenue into a portion of the sales revenue that the parties have agreed is attributable to the original intellectual property rights licensed.

Another alternative may be to fix the amount of royalty payable on a per unit sold basis, so that the licensor shares in the volume success of a product but is not overly compensated for the licensee’s ability to command higher sales prices due to product features and enhancements that are not related to the licensed intellectual property.

A licensor may also consider setting minimum royalty requirements in the Agreement, particularly when an exclusive license right is granted. This both ensures that the licensee is fully exploiting the intellectual property and provides the licensor with the security of a known minimum revenue stream. A licensee’s failure to meet the minimum royalties may entitle the licensor to either terminate the Agreement entirely or change the scope of the license grant, e.g. from an exclusive grant to a non-exclusive grant.

The flip side of minimum royalties are maximum royalties or caps that might be payable in a given period or over the total term of the Agreement. For example, the licensee may want to set an over-all dollar amount of royalties payable, and have the license be fully paid-up after that amount.

Stacking also plays a part in capping royalty payments – if a licensee is at the early stages of commercializing intellectual property, it is possible that full commercialization will require that other third party licenses are obtained. At the time of negotiation of the Agreement, the number and amount of those third party royalties may be unknown. The Agreement could provide for a provision whereby the royalty rate payable to the licensor varies depending on the total amount of third party royalties that the licensee is required to pay, so as to avoid a situation where a licensee is crippled by paying an aggregate of 20 to 30 percent of his revenues away in royalties, making production of a licensed product commercially unfeasible.
(f) **Other Consideration**

A licensor may elect to provide a licensee with rights to intellectual property in return for non-monetary consideration. For example, a cross-license agreement may provide each party with non-exclusive rights to the other party’s technology at no charge. Cross-licensing is particularly common when it is in the interests of all parties to build products to meet a defined set of standards for interoperability.

Parties may also license intellectual property rights in exchange for shares in the licensee company. This arrangement typically involves the setting up of a joint venture, whereby each party licenses its intellectual property to the joint venture vehicle in exchange for shares and, ultimately, a split of the joint venture profits.

(g) **Reports and Audit**

Consideration provisions in a license agreement often include a reporting aspect within the provision itself or close by, particularly when the consideration consists of variable royalty payments. Licensees are typically obligated to send a royalty statement or report with each royalty payment, although if royalties are payable on a relatively frequent basis, reports may only be required at less burdensome intervals, such as quarterly or annually. A licensor may also request that the reports be certified by the licensor’s auditors or chief financial officer.

The reporting clause usually requires the licensee to keep and maintain complete and accurate financial and production records relating to all products manufactured, sold, used, returned and invoiced (if such products relate to the licensed intellectual property) in sufficient detail to allow the licensee to verify such records. Ancillary to the reporting obligation is a right of the licensor to inspect and audit these records, or allow an independent third party to perform an inspection and audit.

Most audit clauses limit the licensor in the exercise of its rights to a specified frequency (e.g. once per year) and only upon reasonable notice and during regular working hours. The cost of any audits are normally borne by the licensor, unless it finds a discrepancy between the royalty amounts actually paid to it and the amounts it should have received, in which case the licensee is required to pay for the audit. Licensors should make it a policy to conduct periodic audits as is their right, as regular audits keep a licensee honest by removing temptations.
5. **Obligations of the Parties**

Each of the licensor and licensee may have obligations to fulfil under the Agreement other than the grant of license rights and the payment of royalties or other license fees. Often the nature of these obligations is dependent upon the nature of the intellectual property licensed and the scope of the license grant. Obligations may either be positive obligations to take certain actions or negative obligations in the form of restrictive covenants.

(a) **Disclosure and Assistance**

If the Agreement contemplates a license grant including know-how, or if the licensor is otherwise expected to disclose information and offer assistance to the licensee in the exploitation of its license rights, then one of the licensor's obligations will be to disclose the required information within a certain amount of time. In addition, the specific assistance to be provided by the licensor should be carefully and clearly set forth. Assistance could consist of training, consulting, technical support or any other services agreed to by the parties.

(b) **Exclusivity**

If the license grant is exclusive, the Agreement may include a provision whereby the licensor agrees that it will not license the technology to any other person within the defined exclusive territory or for use in the defined exclusive field. If the exclusivity is restricted by geographic territory, the licensee may additionally request that the licensor undertake to ensure that its other licensees respect the boundaries of their own respective territories.

(c) **Enforcement of Intellectual Property Rights**

The Agreement should contain a clause indicating which party will be responsible for the maintenance of registered intellectual property rights, and which party is responsible for the payment of all fees associated with those registrations. The licensor almost always takes responsibility for the actual prosecution and maintenance, but may request to be reimbursed for fees, particularly if the licensee is directing the patent filing strategy, or is enjoying exclusive rights to the intellectual property.

Another standard provision in most license agreements is that the licensee will promptly report any infringement of the licensed intellectual property rights to the licensor. Often the licensee is in the best position to be aware of any third party infringing the licensor’s rights, especially when it is the exclusive licensee in a territory in which the licensor has no real interest.
The more difficult question arises after the infringing activity has been reported. Which party should be responsible for incurring the costs of pursuing the infringers and enforcing the intellectual property rights? Some agreements may provide that it will remain within the absolute discretion of licensor whether any corrective action will be taken at all. In such instance the licensor must have secured the agreement of licensee that it would not unilaterally maintain any action for infringement under the licensed properties. However, this may put the licensee at a disadvantage, if it is required to pay royalties for intellectual property rights that its competitors are exploiting for free.

Another scenario may contemplate either the licensor and licensee taking action, usually with the licensor entitled to do so alone and the licensee’s rights crystallizing upon the licensor’s decision not to pursue the infringer. The parties may also decide to take joint action, sharing costs upon some agreed basis and splitting the monetary recovery if any, usually in the same proportion. In most instances, the licensor will want to retain some control over the carriage of the action and/or final say over the terms of any settlement with the alleged infringer.

It is important to note that if the Agreement is silent on the subject of third party infringements, a licensee (even a non-exclusive licensee) has the ability and standing to maintain an action for patent infringement to recover its damages. There is always a danger for a licensor in allowing a licensee to proceed unilaterally. The licensee may do a less than adequate job of defending the properties from the inevitable validity defences, with harmful results to the licensor, especially if the invalidation of the properties would relieve the licensee of its license obligations.

(d) Trade-mark Requirements

Trade-mark license agreements must include unique obligations on the part of the licensee in order to ensure that the validity of the licensed trade-marks is maintained. Because trade-mark rights emanate from actual “use” of the marks, and because it is possible to lose a trade-mark right if the mark itself loses its distinctiveness, licensors must ensure that they maintain control over the ‘quality and character’ of the goods and services with which the licensed marks are associated. If they do so, use of the mark by the licensee is deemed to be use by the owner, and there is no danger of the mark losing its distinctiveness through perceived use by two different sources.

In order to ensure that the necessary controls are in place, common provisions in a trade-mark license agreement include the licensee agreeing to the following:

- The licensed trade-marks will be used only in association with permitted wares and/or services, and such wares and services will meet any quality standards specified by the licensor. This may include an obligation on the licensee to use certain processes or products in its manufacture of licensed articles, if the same are the only ones that can achieve the necessary quality.
- The use of the trade-marks will comply at all times with the standards (including size, colour, font, etc.) specified by the licensor; these may be attached to the Agreement as a schedule, or communicated by the licensor to the licensee from time to time. The licensor may also request that all use by the licensee of the licensed marks be accompanied with a specified notice or legend indicating that the mark is used under license and, if desired, the name of the licensor as owner of the mark.

- The licensor has the right to pre-approve all use of the licensed trade-marks on promotional or other material.

- The licensee shall provide the licensor with samples of products for marking and quality standard verification.

- The licensor shall have the right to attend (or have its designated agents attend) the licensee’s facilities, on reasonable notice and during regular business hours, to inspect the products for verification with quality standards. If the validity of the mark is later challenged, it may not be enough for the licensor to show that it had a right to inspect. The licensor must actually exercise this right, and be able to produce evidence to that effect.

- The licensee shall not use or apply for any trade-mark that is the same as or confusingly similar to any of the licensed trade-marks during or after the term of the Agreement, or use the licensed trade-mark (or any confusingly similar mark) as part of its corporate name.

(e) Covenant to Exploit

The Agreement may include a provision obligating the licensee to use its “best efforts” or “reasonable commercial efforts” to exploit the licensed intellectual property in some manner. This will be of particular interest to a licensor who has granted exclusive rights in its intellectual property to the licensee and who is dependent on a variable royalty for revenue. For example, the licensor will want to ensure that the licensee is contractually obligated to promote, market and sell products to avoid a situation where a licensee ties up a technology and then allows it to languish, thereby precluding a competitor from using the technology but not paying anything for that benefit.
6. **Improvements, Enhancements and Modifications**

Intellectual property protects the expression of ideas. Ideas are not always formed in a vacuum. Inventions are often inspired by existing technology; a person may create and design a new improvement to that technology, or a feature that enhances the use or functionality of the technology. The new invention may come about as a result of an idea that relates to the use of the licensed technology, or it may actually be the result of modification of that technology in order to produce a derivative work or other enhancement.

There is no widely accepted definition for “improvement” in the context of intellectual property licenses, but it is usually used to mean a development within the field of the licensed technology that enhances the usability, functionality, efficiency, performance or other characteristic of the original technology. If used in the Agreement, the parties should be certain to provide a clear definition as to what is contemplated as an improvement, to avoid disputes later on.

(a) **Licensor Improvements**

A licensor may be continually making improvements to its technology, and filing for new intellectual property registrations as a result, even after the effective date of the Agreement. The treatment of those improvements should be negotiated as part of the overall license agreement.

In some cases, the licensee may feel entitled to have all related licensor improvements automatically “deemed” to be part of the definition of licensed technology, so as to not be held ransom by the licensor for incremental improvements to a technology. On the other hand, if the improvements are the result of genuine modifications to a technology (for example, upgrades and new versions of software applications), the licensor may wish to specify that such improvements will be available for license to the licensee, but at an additional fee, usually negotiated in connection with the over-all support and maintenance fees chargeable to the licensee.

At the end of it all, the royalty fee should account for the bargain struck, and a higher royalty may be justified to the extent the licensee is entitled to the benefit of subsequent licensor improvements. It may also be dealt with through an extension of the term of the Agreement (and a corresponding extension of the length of time during which a licensee must pay royalties), particularly if the improvements are patentable.

If the Agreement provides the licensee with some sort of right to the licensor improvements, whether by way of automatic inclusion in the definition of licensed technology or by way of providing the licensee a right to obtain a license to the improvement, there should be a corresponding obligation on the licensor to disclose such improvements in a timely manner.
(b) **Licensee Improvements**

Licensee improvements may be a far more contentious matter to negotiate than licensor improvements. If the licensee intends to actually modify the technology in order to create improvements, the license grant must provide that right. For certain licensed products, such as software, this may require a license of source code in addition to the use license for the object code version of the software.

If the licensee is granted the right to modify, the licensor will usually require that any resulting inventions be disclosed fully and promptly. The licensor may also require that such inventions be assigned to it, in exchange for a license back to the licensee on the same terms and conditions as set out in the Agreement. The justification for the assignment may be that, but for the original license, the licensee would not have developed the technology.

If the licensee wishes to retain ownership of its improvements, the licensor may nonetheless request a non-exclusive license to use those improvements for its own account or to license such improvements to its other licensees. The licensee may even negotiate for a royalty to be paid to it in the event third parties pay license fees to the licensor in respect of licensee improvements.

(c) **Specific Licensee Customizations**

Licensees may wish to modify technology for the purpose of customizing it for their own internal use. In these instances, the parties may agree that the licensee will retain ownership of the intellectual property rights in the customizations with no license granted back to the licensor, provided that the licensee only makes use of such modifications for its own internal business purposes and does not commercialize the modified technology.

The Agreement may then contemplate a modified “support” provision, as the licensor is faced with supporting a technology that is not entirely of its own creation. This is most common in software application licenses. Program problems may be due to changes made by the licensee rather than problems inherent in the original software.
7. **Common Clauses**

In addition to the provisions discussed earlier, there are several other contractual clauses that are common in most intellectual property license agreements.

(a) **Definition of Confidential Information**

Whether or not trade secrets are licensed, it is common for other confidential or proprietary information to be exchanged by the parties in a licensing arrangement. The licensor may be disclosing know-how, or offering technical assistance, that requires the disclosure of information not otherwise available to the public. The licensee may be required to report sensitive financial information to the licensor in order to fulfil its royalty reporting obligations. If the licensor conducts inspections or audits of the licensee’s facilities, it may be exposed to confidential information belonging to the licensee or its employees, suppliers and customers.

It is important to define “Confidential Information” at the outset of the Agreement in order to ensure that each party is fully aware of the scope and extent of its duties, as provisions dealing with the treatment of confidential information commonly impose onerous obligations on the recipient of that information. Most litigation in the area of trade secrets or confidential information arises in situations where neither party is clear as to what was the trade secret or confidential information. On the other hand, a licensor may want protection of what it is entitled to and more, and will sometimes favour a vaguer definition so as to “catch” any and all information.

The Agreement may provide that only information which is marked or legended as “confidential” or “proprietary” by the owner is entitled to be accorded special treatment; if information is disclosed in non-written form, there is usually a provision which allows the discloser to capture that information in summary written form within a prescribed period of time so as to designate the written summary as confidential for purposes of protection.

It may also be desirable to ensure that the definition of “Confidential Information” includes not only information that is actively disclosed to the recipient, but other information which it receives or is made aware of as a result of the Agreement. If necessary, a party should ensure that information that it discloses but does not own (for example, information relating to its affiliates, or third party contractors, etc.) is also covered by the definition.
(b) Treatment of Confidential Information

Whether or not trade secrets are licensed, it is common for other confidential or proprietary information to be exchanged by the parties in a licensing arrangement. The licensor may be disclosing know-how, or offering technical assistance, that requires the disclosure of its proprietary or confidential information. Typically, confidential information and/or nondisclosure provisions in an Agreement include the following:

- A provision whereby each party acknowledges the confidential nature of the information and agrees that it will only use and disclose confidential information belonging to the other party for the purposes of the Agreement. The use should be limited to ensure that the recipient is not deriving additional benefits from the disclosure of the confidential information.

- A provision outlining the exceptions to the obligations imposed on the parties in their treatment of confidential information. Usual exceptions include information that is publicly available, information that is already known to or becomes known to (without any wrongdoing) the recipient, and information that is independently developed by the recipient. The clause may require that a party that is relying on one of these exceptions be able to produce reasonable, documented evidence in support of its reliance, particularly if it is claiming prior knowledge or independent development.

- A provision exempting a party from compliance if under a court order to disclose the other party’s confidential information, provided that the owner of the confidential information is given notice of the court order and a chance to respond and/or contest the order.

- A provision requiring the recipient of confidential information to safeguard it against disclosure, usually with reference to a standard of care that is no less than the standard of care it accords its own confidential or proprietary information.

- A provision stating that the obligations of the parties in respect of confidential information will survive any termination or expiration of the Agreement. The length of time for this survival is sometimes contentious. One the one hand, the owner of the confidential information will want it to be protected forever, until it becomes public. On the other hand, the recipient will want to know, from an administrative and legal standpoint, that there is a fixed point in time after which it is released from its obligations.

- A provision stating that, upon the termination or expiration of the Agreement, all confidential information will be either returned to the owner or destroyed. Recipients may request to keep an archival copy of the confidential information in the event of future litigation.
It is fine for two companies to agree to keep each other’s information confidential, but if the employees who are handling the information are not aware of the company's obligations, the confidential information will be at risk. The recipient of the confidential information should be obliged to advise its employees as to their duties and obligations under the agreement. The obligations "trickle down" to the employees.

The licensor should insist on seeing the confidentiality agreements in place between the licensee and its employees to ensure that such agreements are in place and contain the needed clauses. The licensor should also require that the licensee have adequate confidentiality agreements in place with any third party contractors or other third parties to whom it intends to disclose the licensor’s confidential information.

(c) Representations and Warranties

As with most commercial contracts, license agreements between arms' length parties typically contain a series of representations and warranties. The nature of the representations given depend in part on the type of intellectual property licensed and the relative bargaining power of each party.

In intellectual property license agreements, licensees are most likely to be concerned with the ownership and validity of the licensed intellectual property. A licensee’s worst fear is to be embroiled in an intellectual property infringement action as a result of another party’s trade-marks, or to find out that it is paying a license fee for intellectual property that its competitors are exploiting for free because the patents are invalid.

In addition to the usual representations found in non-license agreements, the following representations relate primarily to the intellectual property being licensed.

(i) **Ownership; Title:** The licensor may represent and warrant that it is the legal owner of the licensed intellectual property (and, in the case of registered intellectual property, the registered owner), and that it owns the intellectual property free and clear of all liens and encumbrances.

(ii) **Non-Infringement:** The licensor may represent and warrant that the use and enjoyment by the licensee of the licensed intellectual property does not infringe any third party intellectual property rights. This representation is often qualified as being “to the best of the licensor’s knowledge”, or otherwise limited to a specific territory.
(iii) **Sufficiency:** The licensor may represent and warrant that all of the intellectual property required to make, use and sell an invention, as an example, are licensed to the licensee. The licensee may request this representation so as to avoid finding out at a later date that the licensor owns additional patents that it needs, and for which it must pay additional consideration.

(iv) **Performance:** The licensee may require the licensor to warrant that the embodiment of a particular intellectual property performs or functions in compliance with agreed-to performance specifications or other objective standards. This is most common in software license agreements. It is critical that the licensor take care in drafting any specifications, as it may be the only objective standard against which to measure compliance with the provisions of the Agreement; too often in a negotiation, the product specification is left "for someone else to draft" (the technical person) while the rest of the obligations under the Agreement are negotiated. This is a dangerous oversight since the licensor's ability to provide and service the product depends upon the characteristics of the product itself.

(d) **Disclaimers and Limitations of Liability**

Warranties may exist outside of the written contract: they may be express or implied. Implied warranties and conditions may arise under contract law or by virtue of legislation such as provincial sales of goods acts, other consumer protection laws, or under the Uniform Commercial Code in the United States. Examples of statutorily implied warranties include merchantability and fitness for a particular purpose.

A licensor must therefore take care to disclaim all warranties and conditions it does not intend to provide through a disclaimer provision in the Agreement. The caveat may be that a disclaimer may not be effective if a product does not work at all, as the total failure to perform may go to the heart of the contract and give an injured party the right to set aside the contract or claim further damages. Any disclaimer clause should be highlighted, with capital letters and/or bold type to ensure that it is brought to the attention of the disclaimee, particularly in the case of shrink-wrap license agreements or other contracts of adhesion.

Limitations of liability operate to exempt the licensor (or either party, if drafted to cover mutual obligations under the Agreement) from specified categories of damages, or to place a maximum limit on the licensor's exposure. Typical exclusions from liability include liability for consequential, special, incidental or consequential damages. The maximum cap on liability is a matter for negotiation by the parties, but is either expressed as a finite number (e.g. one million dollars) or as a function of the amount of consideration paid under the Agreement (e.g. the amount of royalties paid by the licensee in the twelve months preceding the claim).
(e) **Infringement Indemnities**

If the licensor's warranty of title or authority is wrong, then the licensee risks exposure to one of the greatest terrors of the late twentieth century - intellectual property litigation.

Litigation can arise even if the use of the licensed intellectual property infringes the intellectual property rights of others without any deliberate intent by the licensor or licensee (such as in the case of patent infringement). The multi-million dollar questions are: Who shall assume the risk? Who shall pay the damages? Who will pay to fix the problem?

Since the licensor is providing the technology and is making money from the transaction, licensees will insist upon the licensor indemnifying them against such risks, or at least over which the licensor has control. The risks over which the licensor has control and over which the licensee has none include breach of contract including trade secret obligations, patent infringement, trade mark infringement and copyright infringement. The obligation to indemnify may be accompanied by an obligation to defend.

Unless the licensor has knowledge of an existing patent, neither the licensor nor the licensee may have any forewarning of an action for patent infringement. It is a matter of bargaining as to who assumes the risk of patent infringement.

The licensor may wish to limit its obligation to indemnify the licensee under certain circumstances. For example, the indemnity may not apply if the licensee has modified the intellectual property and the modification is the cause of the problem, if the licensee has used the intellectual property for an unintended purpose, or if the licensee has otherwise breached the Agreement.

If any litigation is commenced the person paying the costs of it would want to control the litigation by taking carriage of it and making decisions with respect to settlement. The indemnity usually contains a provision requiring the indemnified party to promptly notify the indemnifying party of any threat to litigate or the commencement of any lawsuit. At the same time, the indemnified party may be required to provide the indemnifying party with all reasonable assistance to allow the indemnifying party to defend the action. Even if the licensor is not defending the action, it may still want to retain the right to approve any settlement which may affect the validity of the licensed intellectual property.

Instead of defending an action, and incurring the costs of that defence, the licensor may wish to reserve for itself the right to either modify or replace the licensed intellectual property with a non-infringing equivalent, or settle with the third party plaintiff and obtain a license so that the licensee can continue to use and exploit the licensed intellectual property. A licensee should ensure that any replacement or modification is functionally and commercially equivalent to the original intellectual property. Another alternative the licensor may request is to pay back to the licensee all royalties paid under the terms of the Agreement, and terminate the license grant.
If the licensee is unable to bargain for an indemnity, and fears that it may end up burdened with the costs associated with any third party infringement action, it may request a provision stating that it is entitled to withhold royalties from the licensor until it has recouped its costs in defending any litigation relating to the validity of the licensed intellectual property.

(f) Product Liability Indemnities

Equally as frightening as the prospect of intellectual property litigation is the threat of product liability litigation. Product liability arises when a defect in the design or manufacture of a product results in death, injury or property damage to another, usually but not always the contemplated end user. Liability usually arises through the tort of negligence, manifesting as a breach of duty owed by a product manufacturer or distributor to ensure that a supplied product is of safe design.

Product liability may be of concern to both the licensor and the licensee, depending on the nature of the intellectual property licensed and the license granted in the Agreement. If the owner of patents relating to a pharmaceutical compound grants a licensee the right to develop, manufacture and sell a drug using that intellectual property, it may wish to be sure that it is held harmless for any class actions relating to the drug product. A patent licensee may, on the other hand, rely on the fact that the patented compound has been tested for toxicity and is safe, and may wish to ensure that the licensor bears the brunt of any claims relating to product safety.

If a trade-mark licensee is receiving products from the licensor and distributing the same by virtue of an exclusive license for a territory, it may seek a product liability indemnification for all products manufactured by the licensor. Trade-mark licensors may be equally concerned where the licensee is manufacturing the products for sale, as the licensor’s name will be associated with defective products.

As with infringement indemnities, the scope of the indemnity provided and any limitations on it are a matter of negotiation.

(g) Insurance

Contractual remedies may only be worth the paper they are written on. All the airtight indemnities in the world may not mean anything if the indemnifying party is bankrupt or insolvent. In view of the foregoing, it is becoming increasingly common in Canada for parties to a license agreement to require the other to maintain insurance on matters such as product liability at an adequate level with such party being named as an insured and with proof of such insurance being provided from time to time.
(h) Assignment Restrictions

Unless the license agreement has stated that the license is "personal" or there is a clause in the agreement limiting either party's right to assign rights and obligations under the license, under Canadian law a party to an agreement is free to assign its rights under the agreement, but cannot assign its obligations without the approval of the other party.

The contrary is true in the United States, where neither party is entitled to assign its rights or obligations under the contract without the approval of the other. A patent license is considered to be "personal" and cannot be assigned without the permission of the licensor.

A licensor may be pleased to license its intellectual property to a small enterprise. If, however, the assets of the licensee are subsequently sold to a competitor of the licensor, the licensor may not want its intellectual property to be available to the competitor. The licensor can control the "re-sale" of the licensee's rights to a third party by having the Agreement limit the assignability of the license. The provision in the Agreement may make the licensor's approval of any assignment in its sole discretion, or it may limit the licensor to being reasonable if it withholds consent.

Licensors should be equally concerned with a change in the corporate control of the licensee which might have a result similar to that of an assignment of the license. If the shares of the licensee are sold to a competitor, or the licensee merges with a competitor, the competitor may gain direct or indirect access to the intellectual property. If this scenario is not desired, then a "change in control" clause should be added to the Agreement.

Similarly, a licensee may not want the licensor to assign the intellectual property rights licensed to it if the licensee is depending on the special expertise of the licensor to aid in the commercial exploitation of that intellectual property, or on the licensor’s support and maintenance obligations. A licensee may want to have the first right of refusal to purchase the intellectual property rights if the licensor eventually find a purchaser.

To the extent assignment is permitted (by approval or otherwise), the provision in the Agreement should provide that the assignee is bound by all of the terms and conditions in the Agreement. The licensor may additionally wish to have the right to keep the original licensee on the hook as a guarantor of the assignee’s obligations.
8. **Conflict Resolution**

Very few rational business people enter into a license agreement with the expectation that the relationship established between the parties will break down irrevocably. Nevertheless, disputes amongst even the most reasonable of people are sometimes inevitable. Most complex license agreements provide for the resolution of conflicts that may arise relating to the Agreement and the licensed intellectual property.

(a) **Escalation**

Prior to incurring the expense of more formal proceedings, the parties to the Agreement may want to ensure that all informal attempts to resolve a dispute have been made. The Agreement may provide for an escalation of the dispute to increasingly senior levels of management, each with a set period of time within which to resolve the dispute. Examples may include the product managers, vice-presidents of developments and finally the CEO of each party. The escalation provision would dictate the notice required and also specify how, when or even whether the parties need to meet to attempt to find a resolution.

(b) **Mediation and Arbitration**

If the parties are unable to resolve the dispute by escalating it through each party’s ranks, the only other option is a more formal dispute resolution procedure. Because of the time and money involved in court proceedings, the parties may wish to include mediation and/or arbitration options. The parties may make these binding, or optional.

The arbitration provision may be simple or complex, depending on how much detail the parties wish to provide. Examples of particular detail in the arbitration provision may include:

- **Number of arbitrators**: A single arbitrator or a panel of three arbitrators are commonly contemplated. If a single arbitrator is selected, the provision typically provides that if the parties fail to agree on the arbitrator, either party may apply to a court to appoint an arbitrator. If a panel of arbitrators is selected, it is common for each party to choose one and for those two arbitrators to jointly select the third arbitrator.

- **Experience of the arbitrators**: The parties may specify that each arbitrator is required to have specific experience and/or qualifications. For example, if the Agreement relates to the license of pharmaceutical compound patents, the parties may specify that the arbitrator(s) be possessed of expertise in the pharmaceutical industry.
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- Confidentiality of proceedings: If trade secrets or other confidential information is involved, the arbitration provision may provide that all information disclosed during the course of the arbitration is to be kept secret.

- Costs: If the parties have negotiated specifically for the allocation of costs attributable to the arbitration, this should be specified in the provision.

- Procedures: The parties may choose to specify in detail the procedures to be followed during the course of the arbitration proceeding, e.g. maximum amount of time for “discoveries”, oral argument vs. written argument, etc.

- Final Arbitration: If the parties wish to bind each other to the decision of the arbitrator(s) with no appeals allowed to the courts, this should be specified.

- Exclusions: The parties may wish to exclude certain matters from being decided by arbitration. Breaches of confidential information, or disputes relating to patent validity, for example, may be matters that the parties wish to litigate through the courts.

- Rules and Governing Law: If the parties have agreed on a set of protocols or rules that they wish to follow (e.g. International Chamber of Commerce, Ontario Arbitrations Act, etc.), this should be specified. The parties may also wish to specify the location of the arbitration in advance. It is common to choose a “mutually inconvenient” location, so that neither party is tempted to commence proceedings with a cost advantage over the other party.

One of the benefits of using mediation, arbitration or other alternative dispute resolution procedures is that the parties may tailor a dispute resolution mechanism to their needs taking into account the importance of the technology and the extent to which they are prepared to go in resolving disputes. The Agreement may also require the parties to continue performance (i.e. the payment of royalties) pending resolution of the dispute.

(c) Litigation

If an alternative dispute resolution procedure is not provided for in the Agreement, a party may still attempt to resolve disputes through arbitration, but will only be able to do so if the other party agrees. If the parties are unable to agree, the only recourse available may be through court proceedings.

In intellectual property licensing arrangements, the established presence and procedures of the courts may be attractive, particularly when one party is seeking interlocutory injunctive relief. The licensor in particular may want to avail itself of this remedy in order to protect its valuable proprietary rights in a timely manner.
9. **Contract Termination and Renewal**

(a) **Term, Expiration and Renewal**

As with any contract, a license agreement should specify the date it commences, the period of time during which the parties’ obligations will be in force, and an expiration date, unless it is intended to be a perpetual agreement. Patent license agreements often expire on the last date of expiry of any licensed patents, and may have long terms. Trade-mark license agreement terms may be for shorter, fixed durations. Software license agreements are often perpetual, especially in the case of commercial off-the-shelf software products.

The Agreement may also provide for a right of renewal. Absence a renewal provision, it is always open to the parties to negotiate for a renewal of the Agreement, on such terms as may be agreed, prior to the expiry date. Often, a licensee will prefer a renewal right so that it does not have to renegotiate key terms and conditions of the Agreement, such as the amount of royalties payable to the licensor.

If the renewal is not automatic, the licensee will be required to provide the licensor with notice of its intent to renew within a set period of time before expiry; if the renewal is automatic, then notice will only be required if a party does not wish to have the Agreement term be extended.

Generally, the length of the term will depend on the intentions of the parties and their relative bargaining power. A licensor may prefer to have a long-term commitment, with (hopefully) an associated long-term royalty revenue stream payable to it. A licensee usually needs to balance the desire to lock down its rights to the technology over a long period of time, and a need to be able to renegotiate the terms of the Agreement if market conditions warrant such renegotiation.

(b) **Right to Terminate**

There are two basic types of termination rights: termination for convenience, and termination for cause.

A party with a right to terminate the Agreement for convenience may usually do so at any time, provided that adequate notice is given to the other party. Licensees typically do not want the licensor to be able to terminate the Agreement for convenience, as they may have a great deal of money invested in a business plan related to the exploitation of the intellectual property, including unrecoverable capital costs.
Termination for cause can encompass any number of events. The most common triggering events allowing a party to terminate for cause include the material breach by the other party of the terms of the Agreement, or the failure of the other party to conduct business in the ordinary course. Notice may or may not be required prior to a party exercising its right to terminate the Agreement; if the provision contemplates notice, the defaulting party is usually entitled to a set period of time to cure the breach and avoid termination.

It is critical that a licensee have the right to terminate the Agreement if the licensed intellectual property is determined to be invalid. A licensee may also wish to be able to terminate the Agreement if it is sued by a third party for infringement, particularly if it does not have a recourse of indemnity from the licensor.

Many license agreements also attempt to provide a party with the immediate right to terminate upon the bankruptcy or insolvency of the other party. However, the effects of a bankruptcy or insolvency on the treatment of intellectual property rights (including license rights) is a murky legal area. The termination may not be enforceable; in any event, a stay of termination may be applied for by a licensee or its trustee in order to be able to maintain its business. Any such provisions should be viewed with a degree of suspicion, and drafted carefully if enforceability is critical.

(c) Effects of Termination

A well-drafted intellectual property license agreement should provide for the consequences of termination on the rights and obligations of each of the parties, in order to avoid additional disputes at a time when the parties may already be on less than good terms.

The licensee’s most pressing business concern will be the ability to wind down and exhaust any existing inventories. From the licensor’s perspective, its most pressing concern is that the licensee discontinue all exploitation of the intellectual property as soon as possible. It may opt to reserve the right to purchase any of the licensee’s existing stock, at cost if the licensee is amenable, rather than extend the license grant. This may be of particular importance in trade-mark license agreements, where the licensor’s primary concern must be the maintenance of the integrity of the licensed marks.

The licensor may also require that the licensee return any and all materials that contain or reflect licensed know-how. This provision may operate in tandem with the provision requiring the return or destruction of all confidential information.
It may also be advisable to specify in this provision of the Agreement whether or not any of the terms and conditions of the Agreement are intended to survive termination or expiration, and, if so, for how long. Typically, provisions relating to the treatment of confidential information, representations and warranties, and indemnity provisions may survive termination. In addition, the parties may wish to specify that any unfulfilled obligations existing at the time of termination (for example, the payment of royalties accrued to the date of termination) will continue to survive until they have been fulfilled.
10. **Enforceability**

(a) **Patent Licenses and Competition Concerns**

In patent license agreements, extending the term of agreement (and the requirement to pay royalties) beyond the expiry of the relevant patents may be problematic unless there is clearly identifiable and separate know-how being licensed. Other concerns relating to competition law may arise if the licensor requires payment of royalties on elements of a device that do not fall within the valid claims of the patents licensed, or if the licensor attempts to require a licensee to purchase unpatented materials from it or designated sources to be employed in a patented processes or with patented equipment.

Competitive concerns may also arise if patents are pooled or cross-licensed between two parties to be administered in accordance with a common purpose to thereby control a business or market which one of the individual participating patentees could not.

The *Competition Act* enumerates the various acts that are considered to be offences under the Act, and the “Intellectual Property Enforcement Guidelines” provide guidance for matters relating specifically to the licensing of intellectual property. Although it is rare in Canada for anyone to be prosecuted under the *Competition Act* in the context of a licensing arrangement, particular attention should be taken when structuring the Agreement to ensure that the parties are complying with the provisions of the Act.

If the Agreement involves a U.S. party and/or is governed by U.S. law, the need to consider competition matters is even more important as U.S. anti-trust considerations pervade almost every aspect of licensing in the United States. By way of example, a licensor in the U.S. cannot discriminate in the terms imposed upon non-exclusive licensees unless a sound business reason for the disparity can be shown.

(b) **Restrictive Covenants**

The Agreement may include restrictive covenants, such as an obligation on the licensee and/or licensor not to compete with the other party. Courts are generally not fond of non-compete provisions, and in order to be enforceable they should be drafted to be as clear and reasonable as possible.

(c) **Boiler Plate**

A license agreement, just like any other commercial contract, may also include standard legal “boilerplate” clauses relating to its enforceability. Typical clauses include:
(i) **Force Majeure**

A "Force Majeure" is some event beyond the control of the parties to the contract which either delays or renders compliance with the agreement impossible. The Force Majeure clause either temporarily or permanently removes a party's obligation to comply with the agreement.

In the case of a long delay by the supplier of a licensed product, the licensee/customer should have the right to terminate the Agreement and obtain the desired product from another supplier.

(ii) **Severability**

If a clause to an agreement is over-reaching, it may result in a court holding the entire agreement to be unenforceable.

A severability clause attempts to sever any "bad" clauses from the rest of the Agreement and allow the rest of the Agreement to stand even if the severed clause is declared unenforceable.

(iii) **Integration; Entire Agreement**

The Integration clause attempts to say that "this is the deal" between the parties.

Any representations or statements made during the negotiation up to the signing of the Agreement is declared not to form part of the Agreement so that any inconsistencies will result in the particular term of the Agreement governing the situation.

Even if the Agreement contains an integration clause, a court may, while interpreting the Agreement, look into the negotiations and circumstances leading up to the Agreement in order to better understand the intent of the parties by the terminology used in the Agreement.

Sometimes these clauses are ignored by the courts and representations made as an inducement to enter a contract have been held by the court to be binding, express warranties.

(iv) **Relationship Between the Parties**

Some agreements contain clauses stating what the relationship is not: such as a partnership, joint venture, an employer/employee relationship.

Such relationships automatically create obligations between the parties (beyond that of licensor-licensee) and the parties to the agreement may not want such obligations to be imposed.
Such clause will not otherwise change the relationship if it can already be concluded by other circumstances (for example, Revenue Canada, considers someone to be an employee if they are under contract for more than five months), but such a clause will assist the parties in arguing that such a relationship does not exist if those other circumstances are absent.

(v) Waiver of Breaches

The parties may wish to allow some flexibility in performance allowing the other party to make small breaches of the Agreement without automatically causing the Agreement to end.

A waiver clause allows a party to waive one breach of the Agreement by the other party, while reserving the right to insist on strict compliance with the Agreement in the future.

(vi) Notice

The notice clause sets forth the address (including the address for copies) where the parties can serve any notice required under the Agreement to the other party, as well as the means of acceptable notice. It is common these days to include methods such as facsimile and even e-mail as sufficient means of providing notice, taking into account customary business practices, but the parties may wish to specify that certain acts requiring notice (e.g. notice of intention to terminate the Agreement) be delivered more formally.

The registered mail procedures should always be left in as an alternative as people have been known to shut down their facsimile to avoid service.

(vii) Governing Law; Forum

When the licensor and licensee are in different jurisdictions, the governing law clause of the Agreement may become contentious. Each party will favour the governing law with which it is familiar. The same principle is true if the Agreement contains a forum clause specifying which courts will have jurisdiction to hear disputes.

If problems arise with the licensee ignoring its obligations, the most efficient action for a corrective remedy will likely be had in the courts of licensee's jurisdiction and thus its domestic law is probably the better choice, though this may be counter-intuitive. Parties often resort to the forum and choice of law that is "mutually inconvenient", so that neither has an advantage. If a governing law clause is left out the Agreement, the laws of convenient forum will prevail.