LITIGATORS CORNER:
How to Negotiate a License That Will Hold Up Later On In Court

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Great. Now that your client has a patent, what does he do with it? How is it going to be exploited? It's true that some inventors have the resources necessary to manufacture, distribute and sell their inventions. But, because most solo inventors are usually not capable of manufacturing and marketing their inventions, they must find a company to do this. And that means a license agreement will be necessary.

A license, of course, is an agreement between two parties (in this case, the inventor and the company he or she hires to manufacture and market the invention) that a court can enforce later on against either party in the event that either party fails to live up to its end of the bargain. It is called a "license" because the inventor/licensor permits someone else, called the licensee, to make a limited and special use of the invention. The terms of the agreement are up to the two individual parties themselves to formulate and incorporate into the agreement, and can vary greatly depending on the special needs, circumstances, and sophistication of the parties. The usual consideration a licensor gets is a *royalty*, which is a percentage of the total dollar value of the sales involving the invention for the life of the patent. There are many, many variations on this theme.

In my fifteen years as an intellectual property litigation attorney, I have litigated many lawsuits on behalf of inventors who *thought* their attorneys had negotiated a strong license in the beginning stages of their relationship with their licensee. But in a number of our firm's cases, these inventors (or their attorneys) had done something wrong — or had missed a seemingly small step along the way. And, once the litigation begins (either with an infringer or with a licensee), you can be assured that a crafty defendant will find a way to use these missed steps to its advantage. My hope is that the lessons my partners and I have learned as litigators will help you minimize your clients' risks when drawing up a licensing agreement, thereby enhancing their (and your) chances of success in litigation later on. A license also has a crucial role in litigation against infringers of your client's patent. This column is limited, however, to the relationship between the licensor and licensee, and will touch on just a few aspects of the license agreement, particularly those of critical importance to the new inventor-entrepreneur vis a vis his license. How a license agreement influences litigation will be the subject of a future column.

My main message in this article is: ***Obtain express provisions in the license for whatever protection your client needs.*** Remember that a license is a contract and therefore a matter of "private" law, which means that a court is duty-bound to respect the agreement reached by the parties, and is not allowed to invent terms or provisions for either party. No court will renegotiate a better deal for your client. On the contrary, if you have not negotiated a strong license, a court is likely to deny your client relief. This leads to the first problem you must solve: the license agreement must include express provisions for the protection of your client's needs.

INCLUDE A BEST EFFORTS CLAUSE IN THE CONTRACT

One kind of protection a new inventor usually needs, especially for a new and unproven product, is to *insure that the licensee means what it says about promoting the invention*. One of our cases is a good example. The inventor/client, a physician, had licensed his invention, a biopsy needle, to a large pharmaceutical company, which already had a similar product on the market that was selling well. The pharmaceutical company had verbally told the doctor/inventor that it would do its best to promote his invention, and he believed the company. However, the company's executives had secretly decided to "shelve" the doctor's invention, preferring to continue selling the company's earlier product, because it had bigger gross margins — even though that product was clearly inferior to the invention.

Not surprisingly, without any marketing effort, the invention flopped. A lawsuit followed. Unfortunately, the inventor lost, even though a memo betraying the company's secret intent was uncovered during discovery. However, the oral promise was judged not to be legally binding, because *a best efforts clause had not been included in the written license agreement*. The unincorporated oral promise was judged to be worthless.

INCLUDE SPECIFIC TERMS IN THE LICENSE

So, to insure that your client's invention becomes a commercially successful product, expressly require that the licensee do its best to manufacture the invention economically, and promote it vigorously. In addition to specifying the types of marketing efforts you expect, there are many other ways to make such an obligation specific. For instance, consider including specific terms such as minimum royalties, requiring the licensee to pay the inventor *something*, even if it sells nothing. (Unless such payments are substantial, however, the licensee will probably consider them a cost of doing business.) Another way to insure progress along the way is to provide target dates for commercialization, possibly with a provision for the cancellation of the license if targets are not met. Whatever terms you and your client choose, the key is to have all these terms written into the agreement.

MAKE SURE THE LICENSEE PROMOTES THE INVENTION

Since all future income from the invention depends on its future sales, make sure that your client's licensee does its best to promote the new invention. Remember, a new idea will not promote itself, so a determined sales and advertising effort will undoubtedly be necessary. So, in the license, at least list the kinds of marketing efforts you expect the licensee to undertake, including but not limited to, advertising the invention, as well as presenting it at trade shows and before potential buyers, etc. And make it clear in the license that if the licensee does not promote the invention so that it sells and the inventor gets a royalty income, the licensee will lose the license — or the arrangement will at least become less advantageous.

BE SPECIFIC ABOUT THE ROYALTY BASE

Think about the royalty base, which is the products that are sold and to which the royalty is applied. I stated earlier that the royalty earned by the licensor is a percentage of sales involving the invention. The base for the royalty must be addressed in a license, because it is important to realize that sales of an invention do not occur in a vacuum. A licensee typically wants a license, not only because it wants to sell the invention, but also because the invention will contribute to its sales of an already-existing product line or product in which the invention is incorporated.

We represented a doctor, who came to us having earlier negotiated a license providing him royalties on the sales of his invention, a catheter for hemodialysis. However, the licensee ended up selling our client's invention in two distinct ways: (1) alone, for approximately $50 each, and (2) as the main part of a kit or tray, which included the catheter, together with scalpels, anesthetics, surgical drapes, bandages, antiseptics and virtually all the tools needed to place the catheter in the patient. The selling price of the kit or tray was five to six times the price of the catheter by itself. However, in both cases, *our client was being paid approximately 6% of the price of the catheter alone*. This was really unfair to him, since without the catheter, there would have been no kit or tray. The invention made possible the surgical equivalent of one-stop shopping. That convenience and efficiency was directly attributable to the invention. To be fair to our client, the original license should have been negotiated differently, so we renegotiated it for him.

When we renegotiated the license we were able to include all of these related products within the scope of the license, and the licensee was required to pay a royalty of 9% on all of them — thereby increasing our client's royalty by a factor of five or six times. This kind of recovery is often recognized in patent lawsuits and is legitimately included in license agreements. Realize that your client's licensee may generate increased sales of unpatented products sold in conjunction with your client's patented product. If the invention has so benefited the licensee, that contribution should be recognized by insuring that the size of your client's royalty is adequate. The lesson is this: ***pay attention to the base for the royalty***. A half-point reduction in a royalty percentage may be offset many times by a larger base for the royalty.

DON'T GIVE AWAY MORE THAN YOU HAVE TO

Don't give away more than you have to. An engineer-client of ours negotiated a license agreement with a foreign electronics manufacturer. Under the agreement, the electronics manufacturer was obligated to pay our client a one dollar royalty for each radio that contained his licensed invention, which included software and hardware design improvements for scanner radios. But once the product began to be manufactured and sold, the electronics manufacturer became greedy and refused to pay our client any royalties, claiming his invention was not being used in the tens of thousands of new radios that were being sold through a large American electronics distributor. Claiming they were using radios that were different from our client's, the foreign company refused to pay him even the minimum royalty they had promised to pay in the agreement. We sued for this client on a contingent fee case.

Luckily, our client had had good advice from the attorney who negotiated his license agreement. He licensed his patent to the foreign manufacturer, but carefully limited the licensee's rights concerning the use of related non-patented technical information. For instance, the technology provided under the agreement included software programs needed to operate the circuitry. The software was copyrightable, another form of protection completely independent of a patent. In addition, the foreign manufacturer also forgot to get long-term rights to our client's trade secrets disclosed under the agreement. As a result, our client was able to bring suit against both the foreign manufacturer and the U.S. distributor, on two substantially independent grounds. And we were able to realize such an excellent contingent fee victory for our client — $3,000,000 — in good part because his license had been properly negotiated in the beginning.

BE SURE TO LIMIT THE BREADTH OF THE LICENSE

The breadth of the license can, and sometimes should, be limited to one field of use. So, if your client, like one of ours, is the inventor of a catheter to be used in hemodialysis, you will want the licensee to market your client's invention only to people in the field of hemodialysis. But it is conceivable that your client's catheter might have other medical applications, as well. For instance, another licensee might market it as a means for introducing toxic chemotherapy drugs directly into the veins of cancer patients. If our doctor had given his original licensee an exclusive license for all purposes, he would have needed its permission each and every time, before he could license his catheter to another medical company that might market it for uses other than hemodialysis. Luckily, this kind of potential problem was prevented in the licensing phase.

The lessons here all point to one thing: When negotiating your client's license, look at all possible ways the subject matter of the licensing agreement can be protected. Intellectual property can manifest itself in a variety of ways, and it can be protected in a variety of ways. There is no point in locking the barn door on the west side of the barn if there are three more doors on the south, east, and north sides.

A good license is not hard to formulate. But crafting a license, like riding a bicycle, isn't easy until you get the hang of it. And the first license you negotiate for a client may set patterns for the future that can be difficult or impossible to escape. List the objectives. Think about how the opposing party can wiggle out of or around the agreement. Finally, remember that a court must by law assume that the contracting parties knew what they were doing when they drew up the agreement. IPT