

CHAPTER 1

Introduction



After reading this chapter you will be able to

- Understand what a license is
- Understand why a license may be desirable
- Know how to choose which intellectual property to license and which to abandon

Background

What a License Is

A license is, simply stated, permission to do something the granting party (the licensor) has the right to otherwise prohibit. In the context of intellectual property (IP) licensing, it is a grant, by the owner of the property, to another (the licensee) of this right to use the licensed rights free of suit by the property owner, pursuant to certain terms and conditions and subject to certain limitations.

The extent of the rights granted in a license may run the gamut from a mere permission to use the licensed property in some limited manner (a nonexclusive license) to all but ownership of the property (an exclusive license). (For more on this topic, see Chapter 2.)

ESSENTIALS of Licensing Intellectual Property

Interesting Facts

- In the United States, royalties from patent licensing have increased from \$15 billion in 1990 to more than \$110 billion in 2000.
- Licensing experts believe that a well-managed IP portfolio should yield 1 percent of a firm's revenues and 5 percent of its net profits. At the same time, however, a recent survey found that two-thirds of U.S. companies own IP that is neither used internally nor licensed to others.
- Investors value a dollar of royalty income four to five times as highly as a dollar of operating earnings.
- Intellectual property was deemed an important factor driving mergers and acquisitions by 51 percent of surveyed business executives.

Clearly, there is money to be made from licensing intellectual property (and from writing books about licensing IP). More significantly, the practice of such licensing is now so widespread and accepted as to be expected by market analysts, shareholders, directors—and those who decide on executives' salaries and bonuses. Indeed, today it is the failure to license which is deemed noteworthy—and unacceptable.

Why, Tell Me Why!

Why license your (or your firm's) intellectual property? There are several reasons. The most commonly heard, and still the most significant, is *money*. Licensing creates revenue. Most licenses bear royalties, either in the form of a lump sum (a paid-up license) or periodic payments based on sales (a running royalty license). Some licenses bear no royalties but are, in effect, an exchange of rights between two IP owners (a cross license). If, however, you consider the cost savings realized by securing a license under the property of another without payment of a cash royalty, even a cross license may be deemed to generate an imputed income.

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Beyond the mere generation of royalty income (by itself, no mean accomplishment), licensing may be utilized as a vehicle for entry into new geographic or product markets. A property owner may grant a license allowing a licensee entry into a geographic market not served by the licensor or allowing introduction of a product not offered by the licensor. The licensee bears all of the risks attendant on such a new venture and pays a royalty for the privilege. The licensor collects the royalty and observes the licensee. If the licensee's efforts prove successful, the licensor may enter the market as well (assuming, of course, that the license was not exclusive; more on this later). If, however, the licensee's efforts end in failure, the licensor has learned a valuable lesson at no cost to itself.

Somewhat ironically, licensing may, under some circumstances, also serve to strengthen the licensor's market position. Many firms will refuse to purchase a product available only from a single source, thereby placing themselves somewhat at the supplier's mercy. Such firms will demand that a patentee, for example, grant licenses to others (automobile manufacturers are famous—or infamous—for this).

Licensees also may serve to provide variety and breadth of choice in a market where a monopolist is able to offer only a limited product line. Similarly, they may develop improvements or ancillary products or services, all of which serve to increase the attractiveness of the basic, licensed product. A moderate slice of a large pie may well be bigger than all of a small pie.

Licensing also has the effect of strengthening the licensed properties. In part, this is the result of co-opting of potential infringers (i.e., converting them into licensees). With respect to patents, a further benefit obtains. The recognition, by others, of the validity of patent rights, as evidenced by the presence of licensees paying royalties ("putting their money where their mouth is"), is deemed by the courts to be a "secondary indicia of patentability" (a good thing!). The more licenses that

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are granted, the stronger the licensed patents become (the greater the likelihood the validity of the patent will be upheld at trial).

By broadening the availability of a patented technology, licensing may lead to the incorporation of the technology into an industry standard. The implications of such incorporation on future royalty income should be readily apparent to all. Finally, licensing of a pioneering invention or technology may reduce the concerns of those charged with enforcement of the antitrust laws (or reduce the threat of those who might seek to utilize these laws for their own purposes).

What to License

Having seen all the benefits to be derived from licensing, the reader is probably asking, "How can I get in on this great opportunity?" After some thought, it seems that the proper question is really "Which of my intellectual properties should I seek to license?" (If you don't have any intellectual property, you've got a bit of a problem.)

The starting point, obviously, is a thorough analysis of the intellectual property portfolio, the contents of which can be broadly divided into two categories: property that is in use and property that is not in use. It is commonly believed that any property not in use is available to be licensed. Not necessarily so. Some unused IP is held and maintained specifically to deny it to a competitor or potential competitor. Check before you start offering such unused property to any and all comers. Some property is unused because it is simply unworkable, obsolete, or otherwise not commercially desirable. Check before investing substantial efforts in licensing a property. If a patented technology is unused and not likely to be used in the future, is not to be denied to others, and is not attracting any licensees, you should abandon it and save any future prosecution costs or maintenance fees.

Properties that are in use are divided, by some commentators (a euphemism for prolific writers with little experience), into those used

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in key products or services (so-called core properties) and those used only in ancillary or less important products or services or not at all (not surprisingly, known as noncore properties). At least until relatively recently, it was conventional wisdom that noncore properties may be licensed, but core properties—the “crown jewels”—are to be held inviolate. With respect to the noncore properties, the conventional wisdom is correct. With respect to the core properties, it is *wrong*. As noted, the market for a product or service—even a key product or service—may, under some circumstances, actually increase as the result of licensing an underlying technology. Moreover, there may well be market segments that the property owner cannot address, does not wish to address, or cannot fully satisfy. Such market segments offer licensing opportunities. The conclusion to be drawn is simply this: Any useful properties should be considered as licensing candidates, while any nonuseful properties should be considered as candidates for abandonment.

The Extent of Licensing in the U.S. Economy

A Bedtime Story

Once upon a time, a long time ago, there lived several domestic commercial tribes of people. Each of these tribes owned trees that gave forth fruits, from which they made various products upon which they feasted. The managers of these tribes built great legal castles where they hid their trees to protect them from dragons and ogres and others that might wish to eat the fruit. As time went by, however, many of the trees suffered from lack of cross-pollination due to their isolation and produced less and less fruit. Some of the trees expired, either having reached the end of their statutory terms or from other causes, and were not replaced. Steadily, the fruit harvest diminished. At the same time, unnoticed by the managers, a portion of the fruits, of a variety not used

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by the tribes, were left hanging on the branches of the trees until they rotted and fell away. Ultimately, many of the tribes began to go hungry and their numbers became fewer and fewer.

As they cast about for a means to assuage their hunger, the managers noticed that one tribe—in Texas—continued to feast regularly and, indeed, grew large and prospered. And so it came to pass that the managers from the other tribes studied the ways of the wise and successful Texan managers. They observed that the Texans did not hide their trees in the dark. Indeed, they allowed others to pick from their trees those fruits that the Texans themselves did not use—and sometimes the Texans even shared with others the fruits they *did* use. The others paid the Texans great royalties for the fruits they took. The managers who observed this predicted that the Texans' trees would soon be exhausted and their harvest would diminish; but, to their wonderment, the Texan's trees blossomed. The managers also saw the Texans exchange fruits with other tribes and use the new fruits they obtained to make new products.

Some of the managers refused to change from their old ways. They're now flipping burgers for the McDonald tribe. Other, more enlightened, managers adapted the practices of the Texans and lived happily ever after.

THE END

Summary

A license is a grant by an intellectual property owner to another party (the licensee) of the rights to use the IP. A license may be royalty-bearing or non-royalty-bearing (as in cross licenses), and a royalty-bearing license may be either paid-up or bear a running royalty, where the royalty is based on the sales of the licensed goods or services.