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The Patent License Agreement

Summary of a 1989 talk on patent licensing given by Mr. John Sobesky, senior partner with the Michigan patent law firm, Harness, Dickey & Pierce.

Patent license agreements are based on two bodies of law -- the *law of contracts*, which enforces the promises of people, and the *law of torts*, which enforces the reasonable conduct of people.

A typical agreement is outlined below. The headings shown are representative of the kinds of things you should think about (and cover) in a patent license agreement. Your actual agreement may have different headings, more or fewer, and the points mentioned may be covered in different order. It is important only that you give thought to these points, and make certain they're covered somewhere.

Note that these points are generally applicable to license of other intellectual property rights. Note also that the main difference between a license and an assignment is that the former provides that the Licensor retains legal title of the property and the latter does not.

I urge you to retain an attorney in the preparation (and negotiation) of your agreement and, in particular, a patent attorney, i.e., one who understands the problems encountered under intellectual property law.

Heading-Parties-Date.

This agreement is effective as of such and such a day, by and between you, your address (hereinafter referred to as Licensor), and ABC Company, a corporation of Michigan, their address (hereinafter referred to as Licensee).

Recitals-Background.

Material to aid in interpreting the agreement. It's usually not a binding part of the agreement (but may be made so if the attorney desires). Construction is generally along the following lines:

Witnesseth,

Whereas John Doe is the inventor of such and such, and has patents related to such and such, and

Whereas, ABC Company is in the business of manufacturing such and such, and is interested in obtaining a license, etc.

One can continue on with as many such recitals as deemed

appropriate. This is generally followed by a statement such as:

Now therefore, in consideration of the mutual covenants and promises hereinafter set forth, it is mutually agreed by and between the parties hereto as follows:

Now we get to the main body of the agreement. These are the promises that the parties are making to each other. If these promises are not kept, then presumably there is a breach of contract. Under the law of contracts, there are remedies for the breach. The contract itself will provide some remedies -- the law of contracts will provide others.

Definitions.

Devote some time to the definitions. They make it easier to write the rest of the agreement in a form that's easier to understand. Generally, you'll want to identify the licensed patents, licensed products, territory covered, and such terms as Net Sales, Improvements, etc.

Grant of License.

Is the license to be exclusive or non-exclusive? May the Licensee grant sublicenses? What rights do you reserve solely to yourself? Make sure these are clearly stated.

Payments.

Are there to be minimum payments per period? How much (in dollars or units)? This is especially important for exclusive licenses. What is the royalty percentage, and what is it based on? This is usually Net Sales. Who will pay the patent expenses, if it's still pending, and the patent maintenance fees?

Records and Reports.

What reports will the Licensee provide to verify the base that your royalty is applied to? When? This is usually quarterly. What access do you have to Licensee's records for audit purposes, and what is the procedure? How long must the Licensee retain these reports after termination?

Improvements.

What happens in the event you make improvements in the invention? What happens in the event Licensee makes improvements in the invention?

Infringement.

Who's responsible for enforcing (ie., prosecuting infringers of) the patent? Keep in mind there may occur situations in which it is in the Licensee's interest to let the patent fail. What happens if Licensee's product(s), based on your patent, infringes the patents of others. You should avoid taking on this responsibility.

Patent Markings.

If a patent number can be put on a product, it's good practice to require that it be done.

Other Obligations of Licensee.

Will Licensee promise to produce some quantity-level of product? Some dollar-level of sales? To use best efforts to commercialize? To maintain some quality level? Does Licensee indemnify you for product liability? If so, make sure that's clearly stated, and that it survives termination of the agreement.

Disclaimer of Agency.

Statement that the parties are independent contractors, ie., the actions of one are not binding on the other.

Insolvency of Licensee.

What happens if the Licensee goes out of business? Becomes insolvent? Declares bankruptcy? Be sure to include provisions that automatically return the rights to you, and don't get tied up with Licensee's encumbered assets.

Waivers and Modifications.

Statement that occasional waiving of your rights, eg., acceptance of late payments, does not alter your contract rights. Statement that the contract can be modified only in writing.

No Warranties.

Statement that you are providing no other warranties. Avoid warranting Licensee's freedom from infringement of patents of third parties. Try to avoid warranting that the patent(s) is valid. Try to avoid being deemed a "merchant" under the Uniform Commercial Code -- the UCC is stacked in favor of the buyer. Try to exclude any liabilities for consequential damages.

Notices.

What notices are required? Where and to whom are they to be sent? When do they become effective?

Transfer of Interest.

Can Licensee transfer its rights? You would typically prefer not.

Term.

How long is the license to last? Generally it's to expiration of the patent (or the last expiring patent), except as provided under Termination.

Termination.

This is an important section -- it's your way out if things don't work out as expected. Include any defaults not covered elsewhere. What is the form of notices of default? How long has Licensee to correct defaults? What happens to Licensee's products in process? Orders in

process?

Compliance with Law.

What laws can be violated by Licensee? Import-export regulations? Anti-trust? EPA? FDA? Make sure Licensee agrees to obey and conform to such laws and regulations.

Entire Agreement.

Statement that this is the entire agreement, and that you're making no other representations. Try to exclude any liability for (your) misrepresentation.

Final Provisions.

What law governs the agreement? Statement that the agreement is binding on heirs, successors, etc. Statement that headings are for convenience and not binding.

Execution of Agreement.

In witness whereof, the parties have caused this agreement to be executed by the duly authorized officers at the places and on the dates indicated below. Related Issues

Other Considerations

The following topics frequently come up in patent license negotiations. They are best dealt with by separate agreements.

Know-how and technical assistance.

Licensee may wish certain services, or materials, from you in addition to the patent rights conveyed above.

Trade secrets.

Licensee may wish certain trade secret rights in addition to, or in place of, the patents rights conveyed above.

Options.

Licensee may wish some time before executing the final agreement. This can be covered in an option agreement, attaching the license agreement. In return for some consideration, you give them an option, for a specified time, to acquire the license.

Royalties

As a general rule of thumb, at least as a starting point, you can expect a royalty of about 5% of net sales. Be aware that this varies considerably across industries -- it's certainly not 5% in the auto industry.

Recognize that you are trying to combine your rights and the Licensee's resources in a way that will benefit both of you. The Licensee is looking at

profitability. It's trying to balance its risk against its potential gain. In negotiations, try to quantify this. The general feeling is that the Licensor should get about 25% of the pre-tax profitability and the Licensee about 75%.

Above all, don't over-price -- this is the worst deterrent to successful licensing.

Negotiations

The key to successful negotiation is thorough preparation. Know your own (reasonable) goals, and understand, as best you can, where the other party is coming from.

During negotiations, remember that your objective is a win-win resolution. Be flexible. Control your impatience, your anger. Listen. Watch for communication gaps, and resolve them. And above all, maintain a sense of humor.

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