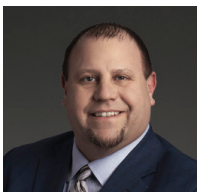


Patent Licenses: Licensing Fundamentals

A Lexis Practice Advisor® Practice Note by Michael J. Kasdan, Wiggin and Dana LLP



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Although federal patent law controls the creation of patent rights and assignments of those rights, patent license agreements are generally governed by state law. Patent license agreements are subject to the general requirements of contract law, and are created only where there is an offer, acceptance, consideration, and a writing to satisfy the statute of frauds, if applicable.

Patent license agreements may take many forms. Some licenses are detailed, fully-negotiated, integrated agreements that result from weeks of negotiation. At the simplest level, a patent license is an agreement by the licensor/patent owner that a licensee will be free from infringement claims that would otherwise arise from the licensee's use of the patented technology. Despite the simplicity of this essential characteristic, however, your client is likely to find that detailed contract terms relating to the parties' ongoing business relationship will be critical to the success of the licensor/licensee relationship. In most cases, the license will be performed over the remaining term of the licensed intellectual property rights, which likely will cover many years. During that time, new products may be developed and introduced, the parties' businesses may change or be sold, markets may expand, and technologies may evolve. Thus, when drafting or reviewing a license agreement, the terms should be written to deal with the parties' changing performance and business relationship over the entire contract term.

The basic components of a patent license include:

1. Parties
2. Preamble/Recitals
3. Definitions
4. Identifying Patents Subject to the License
5. Grant Clause
6. Payment & Royalty Provisions
7. Representations and Warranties
8. Provisions That Protect Against Risk and Govern Future Disputes
 - No Contest Clauses
 - Indemnification
 - Dispute Resolution
 - Choice of Law & Venue
9. Term & Termination
10. Assignability
11. General Contract Provisions
 - Notice
 - Confidentiality
 - Severability/Survival Clause
 - Integration/Merger Clause
 - Choice of Language
 - Statute of Frauds – Written Agreement Requirement

See also [IP License Agreements: General Contract Provisions](#)

12. Continuing Obligations During the License Period

- Patent Marking
- Improvements & License/Grant Backs
- Effect of Invalidity

See also [Patent Licenses: Continuing Obligations during the License Period](#)

13. Change of Corporate Control/Bankruptcy

- Mergers
- Transferring Rights Under an Agreement to a Different Corporate Entity
- Bankruptcy

See also [IP License Agreements: Change of Corporate Control and Bankruptcy Issues](#)

Beyond these basic components, certain industries may commonly include industry specific provisions, such as regulatory milestone provisions in a pharmaceutical license.

Patent licenses can help the licensing parties achieve multiple business objectives and arise in a wide variety of contexts, from ordinary sales of goods, to settlement agreements resolving intellectual property disputes and complex, multi-party technology development agreements. If, for example, your client seeks to generate revenue from its patent portfolio, or needs to access technology rights from other companies in order to bring a competitive product to market, it should consider the benefits and potential risks of licensing.

Patent License-In, Patent License-Out, and Patent Cross-Licenses

The most common forms of licenses are so-called license-in and license-out transactions. In a license-in, your client seeks the right to use a given patented technology, and is in the position of being a licensee. In a license-out, your client seeks to authorize a given licensee to practice their patented technology and is in the position of being a licensor.

Sometimes when both companies have patent portfolios, the parties will grant licenses to each other, with each party being both a licensor and a licensee. This type of transaction is called a cross-license.

Mass Market Licenses

If your client distributes a commercial product on a mass scale, such as packages of software or smartphone applications, it is probably impossible and certainly impractical to negotiate executed license agreements with each customer. Instead, a standard license is usually used to effectively serve as a "one-size-fits-all" mass market license.

The mass market license agreement may take many forms and arises out of different scenarios. Most mass market license issues arise from end user license agreements created in connection with the distribution of copyrighted computer software, such as the license agreement that a computer user agrees to when downloading software using a web browser. Examples of these types of agreements include:

- **Clickwrap License:** A clickwrap license is created online when a user signifies his or her assent to the proposed license terms by clicking an "I Agree" box, or performing some equivalent act.
- **Browsewrap License:** In a browsewrap license, a user merely proceeds to a webpage after receiving notice that the site is governed by posted terms of use without having to explicitly agree to the license terms.
- **Label License:** A label license arises from a statement placed on a patented product or associated packaging visible to the purchaser at the time of sale.
- **Shrinkwrap License:** A shrinkwrap license typically arises out of an end user license agreement located in a shrink-wrapped retail package containing computer software media.

In mass market licenses, the seller of a patented article occasionally seeks to restrict the buyer to a single use, or prohibit the resale or disposition of the article. To the extent such restrictions are enforceable, they are enforceable only as a matter of contract law. Claims for patent infringement based on a violation of post-sale restrictions on use or resale are barred under the doctrine of patent exhaustion. See *Impression Prods. v. Lexmark Int'l, Inc.*, 137 S. Ct. 1523, 1533 (U.S. 2017). In order to create enforceable use restrictions, the transaction must be structured to create a valid standard form license agreement. Formal execution is not required to create a binding license so long as the existence of an agreement is apparent, including through the parties' conduct indicating recognition of an agreement.

Some terms dictated by licensors in mass market license agreements may be unenforceable as unconscionable on public policy grounds. Courts have held that traditional

unconscionability principles apply to arbitration clauses contained in mass market licenses, and user agreements with onerous arbitration and venue restrictions that effectively prevent users from seeking redress can be held to be unconscionable. See, e.g., *Comb v. PayPal, Inc.*, 218 F. Supp.2d 1165, 1177 (N.D. Cal. 2002).

Clickwrap Licenses

Most computer software for public use is distributed via the internet. With few exceptions, the downloaded software is subject to user restrictions contained in an end user license agreement. The enforceability of the "clickwrap" agreements has been litigated extensively. As a result, clickwrap licensing provides useful guidance concerning the enforceability of mass market license agreements generally.

The following tips relate to creating enforceable clickwrap licenses:

1. If possible, where a licensor's product is being used in a workplace, try to verify that the user is authorized by his or her employer to assent to agreements on the employer's behalf. In a recent case, the court refused to enforce a clickwrap agreement when an employee did not have authority to bind his employer, and the employer had provided notice to the would-be licensor that only three designated company officers had authority to enter into binding agreements. *National Auto Lenders, Inc. v. SysLOCATE, Inc.*, 686 F. Supp.2d 1318, 1322-23 (S.D. Fla. 2010), *aff'd*, 433 Fed. Appx. 842 (11th Cir. 2011). For example, a licensor may require the person accepting the terms of clickwrap license to accept a separate representation that he or she has authority to do so.
2. A user should manifest their assent to the proposed terms by a physical act using an assent device, such as clicking an "I Accept" box or entering identifying information, such as a name or email address. The device should clearly inform the user that the action signifies acceptance of all proposed terms. If practical, the device also should include an option for rejecting the proposed agreement, such as an "I Decline" box.
3. The user should have an opportunity to easily review the entire agreement before accepting. The terms should be on the same webpage as the assent device, and preferably should appear above the device. It may not be sufficient to link to the license text on a different webpage, or to email the license to the user at a later time. Some licensors place the acceptance prompt at the end of the agreement, requiring the user to scroll through the entire text of the agreement before accepting the terms.
4. The user must be required to assent to the proposed license terms before initiating any transaction, including

payment, access to information, or download software. All users should accept the terms of the agreement before accessing the licensed product or information. In other words, users should not be able to circumvent the acceptance mechanism by using a "back door," and your client should avoid entering into separate license arrangements for individual users outside of the company's standard clickwrap license.

5. Clients should create and maintain a record of all users' assent and the applicable terms.

Label Licenses

Patent licenses can also be created by conspicuous "label licenses," which propose terms governing a buyer's use of a product at the time of sale. Several courts have recognized the enforceability of use restrictions in label licenses. The cases seem to base their rulings on contract law, although the typical label license does not require the user to take any affirmative act to manifest assent to the restrictions, unlike in the case of clickwrap licenses. See, e.g., *Arizona Cartridge Remanufacturers Ass'n, Inc. v. Lexmark Intern., Inc.*, 421 F.3d 981, 987-88 (9th Cir. 2005), *Monsanto Co. v. Scruggs*, 249 F. Supp. 2d 746, 754 (N.D. Miss. 2001), *aff'd*, 459 F.3d 1328 (Fed. Cir. 2006).

Based on current case law, when drafting or reviewing a label license imposing use restrictions, to avoid any antitrust implications you should:

1. Make sure that the label license, particularly the use restrictions, is conspicuously placed on the product or packaging, and is visible at the time of sale.
2. Refer to the restrictions in informational material describing the product, so that customers are aware of them.
3. Consider indicating on the label that the restricted use terms result in a lower price than if the same product was sold without use restrictions.
4. Make sure the use restrictions track the protected characteristics of the patented article, and relate to subject matter within the scope of the patent claims. For example: "The appropriate criterion is whether [the] restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), *abrogated regarding exhaustion analysis by Impression Prods. v. Lexmark Int'l, Inc.*, 137 S. Ct. 1523, 1530 (U.S. 2017).
5. Consider using a clickwrap or other license structure requiring the user to signify assent with an affirmative act, rather than a label license.

Implied Licenses

Patent licenses or quasi-license rights sometimes arise without a written agreement or formal assent. Licenses may be implied by the course of conduct of the licensor based on theories including estoppel or acquiescence.

Frequently, the critical issue when analyzing implied licenses is not whether an implied license exists, but the extent of the rights granted to the licensee under the license. For example, a customer may receive an implied license relating to a patented article, but, without a written agreement, it may be unclear whether the right is limited to the use of the article, or whether it also includes manufacture, sale, or importation.

Estoppel

Implied licenses may arise based on conduct of the parties which creates an estoppel. If a patent owner acts to induce another party to use a technology in such a manner that estops the patent owner from thereafter denying authorization to practice the patented invention, an implied license exists.

For an implied license by estoppel, you must establish that:

1. A relationship existed between you and the patent owner
2. The patent owner granted you a right to use the technology
3. The patent owner received valuable consideration for the grant
4. The patent owner later denied the implied license -and-
5. The patent owner's statements and conduct created the impression that it consented to your making, use, selling, or importation of the invention

Wang Labs, Inc. v. Mitsubishi Electr. America, Inc., 103 F.3d 1571, 1579 (Fed. Cir. 1997).

An implied license also may be based on conduct of the parties that sounds in "quasi-contract." In these situations, a license is implied from the circumstances, even though there was no actual meeting of the minds on the question of authorization. One such example is the "shop rights doctrine," which provides an employer with an implied, royalty-free license to inventions created by an employee using the employer's facilities, equipment, labor, or other resources. See *McElmurry v. Arkansas Power & Light Co.*, 995 F.2d 1576, 1580-82 (Fed. Cir. 1993). This "shop right" belongs only to the employer, however; the employer does not necessarily have the right to sell the patented invention to a third party. *Beriont v. GTE Labs., Inc.*, 535 F. App'x 919, 923-24 (Fed. Cir. 2013).

The Federal Circuit has held that an implied license may apply automatically to continuations of previously-licensed patents. *Gen. Protecht Grp., Inc. v. Leviton Mfg. Co.*, 651 F.3d 1355, 1361-62 (Fed. Cir. 2011); *Cheetah Omni LLC v. AT&T Servs.*, 949 F.3d 691 (Fed. Cir. 2020). An implied license does not automatically apply to future patents, however, when the new patents are sufficiently distinct from the original patent. *Endo Pharm. Inc. v. Actavis, Inc.*, 746 F.3d 1371, 1378 (Fed. Cir. 2014). Finally, courts may find implied patent licenses where the parties have agreed that one party could engage in certain conduct, such as the manufacture and sale of a particular product, and a right to practice the other party's patent is necessary to accomplish the conduct. See *TransCore, LP v. Elec. Transaction Consultants Corp.*, 563 F.3d 1271, 1279-80 (Fed. Cir. 2009).

Patent Exhaustion

One issue related to but distinct from implied licensing is the rights that a purchaser of a patented article receives upon the authorized, unconditional sale or license of the article. Considerations of patent exhaustion most often arise when seeking to license at different levels of the supply chain.

Under the doctrine of patent exhaustion, the purchaser receives the right to use, resell, rent, or otherwise dispose of the article without further authorization from the seller. Patent exhaustion occurs whenever the patentee, or an entity authorized by the patentee, makes an unconditioned sale of a patented article. For example, if a patentee licenses a fabricator to make and sell patented articles, and the manufacturer sells an article to a third party in an unconditioned sale, the third-party customer receives an implied license to use (including repair), sell, offer for sale, or import the article. It does not receive the right to make the article, nor the right to transform it so significantly that it amounts to a reconstruction. Further, the right to repair does not permit the customer to repair components by replacing them with components that are protected by other utility or design patents that the seller may have acquired. See *Auto. Body Parts Ass'n v. Ford Glob. Techs., LLC*, 930 F.3d 1314 (Fed. Cir. 2019). Patent exhaustion also passes to subsequent downstream owners of the article. The initial sale or license of a patented article exhausts the patentee's monopoly in that item, and confers on the purchaser, or any subsequent owner, the right to use or sell the thing as it sees fit. *Bowman v. Monsanto Co.*, 569 U.S. 278, 283 (U.S. 2013). This is true even when the "sale" involves no consideration – the doctrine of patent exhaustion may still apply when a product is distributed for free. *LifeScan Scotland, Ltd. v. Shasta Technologies, LLC*, 734 F.3d 1361, 1374 (Fed. Cir. 2013).

In order to prevent customers from receiving the right to resell or reuse the patented article, sellers have resorted to a couple of options:

1. Transfer possession of the article in a transaction that is not a sale, such as a lease.
2. Make the sale conditional by subjecting the purchaser to use restrictions, such as by creating a license at the time of sale that restricts the purchaser's rights to use the product. For example, a seller of genetically modified grain may limit sales to farmers who have entered into agreements with the seller restricting the right to reuse harvested crops. An implied license does not arise from patent exhaustion where the sale is conditional.

The Supreme Court opined recently, however, that once goods are sold, patent exhaustion applies and downstream purchasers of those goods from the licensee are free from claims of patent infringement, even where the licensee is subject to certain restrictions in the license. *Impression Prods. v. Lexmark Int'l, Inc.*, 137 S. Ct. 1523, 1533 (U.S. 2017). Licensors may certainly bring claims for breach of contract against the licensee for violating restrictions in the license, but generally will be unable to bring infringement lawsuits against subsequent purchasers. 137 S. Ct. at 1534-35.

Patent exhaustion also applies to patents not embodied in the article sold, when the article sold has no non-infringing use and when the circumstances plainly indicate that an implied license should be inferred, such as when the seller did not disclaim a license at the time of sale. See, e.g., *Met-Coil Systems Corp. v. Korners Unlimited, Inc.*, 803 F.2d 684, 686-87 (Fed. Cir. 1986). The implied license can apply to both apparatus and process patents. See *Keurig, Inc. v. Sturm Foods, Inc.*, 732 F.3d 1370, 1374 (Fed. Cir. 2014). In addition, the sale of a component may result in an implied license to use the completed apparatus in a manner covered by a patent when two requirements are met: (1) the only reasonable and intended use of the component must be to practice the patent, and (2) the component must embody the essential features of the patented invention. *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 631 (U.S. 2008). One important distinction between implied license and the doctrine of patent exhaustion is that any implied license rights may be proscribed by simply stating in the license agreement that there is no intent to grant any implied licenses. By contrast, patent exhaustion operates by law, and may provide rights to third parties even where the parties expressly seek to reserve the right to proceed against those parties. See e.g., *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 637 (U.S. 2008); *TransCore, LP v. Elec. Transaction Consultants Corp.*, 563 F.3d 1271, 1275 (Fed. Cir. 2009).

Sublicenses

If the license is an exclusive license, it generally includes a right to grant sublicenses because the licensee is paying for the ability to control the technology in the market. In the case of non-exclusive licenses, however, the licensee may or may not have the right to grant sublicenses. If the licensor intends to remain the sole source for the subject technology, then allowing a licensee to grant sublicenses would compete with the licensor's own licensing program. In some situations, however, sublicensing is necessary to the effective use of the patented inventions. For example, if the licensee is not the entity that makes, uses, or sells the licensed product, it will want to sublicense rights to that entity. In other situations, sublicensing even by non-exclusive licensees may help promulgate a new technology in an industry, increasing that chance that it will become the de facto standard technology.

"Have Made" Rights

Even if the license agreement does not expressly grant to the licensee a right to grant sublicenses, the licensee may have an implied right to extend rights under the license to third parties. Specifically, the license grant may include the right to have articles embodying the invention made by a third party fabricator. For a more detailed discussion on "have made" rights, see [Patent Licenses: Key Provisions – Rights Granted to a Patent Licensee](#).

Patent Exhaustion

Regardless of whether a license agreement provides the licensee the right to grant sublicenses, the licensor should be aware that, in effect, a licensee may create rights for third parties to practice the invention simply by selling a patented product to those third parties in an unconditional sale. The doctrine of patent exhaustion ordinarily will result in similar rights among purchasers of the licensee's products, and downstream purchasers of those articles. Upon the unconditional, authorized sale of an article embodying a patented invention, the patentee's rights to exclude others from using, selling, offering for sale, or importing the article are "exhausted", even though the transaction does not include an express license. Downstream users then may purchase or use the article without liability for infringement. While technically not a sublicense, patent exhaustion creates very similar third party rights to practice the licensed patents. See also *Impression Prods. v. Lexmark Int'l, Inc.*, 137 S. Ct. 1523 (U.S. 2017).

Sublicense Agreements/Provisions

Especially in non-exclusive licenses, sublicense provisions raise a number of critical issues. First, a non-exclusive licensee does not have the right to grant sublicenses without express authorization in the license agreement. An agreement silent on the issue does not include a right to sublicense. If the licensor intends to retain some control over the availability of technology in the market, the sublicense right may be restricted. Some license agreements may allow the licensee to grant sublicenses only with the licensor's prior consent. Other licenses may contain a "veto" list of companies which may not receive sublicenses, generally direct competitors of the licensor.

The relationship between a licensee and third parties must be carefully evaluated to determine whether a transaction actually creates a sublicense. For example, in *Unidisco Inc. v. Schattner*, 824 F.2d 965, 968 (Fed. Cir. 1987), a licensee's exclusive distributorship arrangement with a third party was not analyzed as a sublicense, but as an authorized sale of patented products, which did not require a grant of sublicense authority, whereas in *Cook Inc. v. Boston Scientific Corp.*, 208 F.Supp.2d 874, 879-80 (N.D. Ill. 2002), a licensee's distributorship arrangement with a third party did constitute an unauthorized sublicense. The language and structure of a license agreement surrounding "have made" and "sell" rights are relevant considerations when determining whether a transaction constitutes a sublicense.

The licensor may provide limits on the terms for the sublicense, and may include a form of sublicense agreement as part of the license itself. The sublicense may require additional terms for any sublicenses, such as indemnification rights for the benefit of the licensor or a requirement that the sublicensee mark its products with the appropriate patent information.

One problem concerning sublicenses is the status of the sublicense if the underlying license is terminated, such as due to the material default of the licensee. Normally, in the absence of a controlling provision in the license, termination of the main license results in the termination of any sublicenses. If, however, the licensor approved the sublicense

and accepted performance from the sublicensee, courts have held that sublicenses continue despite the termination of the underlying main license. Thus, parties should consider addressing this potential issue in their license agreement, such as by providing that upon termination of the main license, all sublicenses are also terminated or, alternatively, are automatically assigned to the licensor.

Sublicense Royalty

Managing licenses created as part of an aggressive licensing program can be time-consuming. One advantage of sublicensing from a licensor's point of view is that the licensee is responsible for managing sublicensing royalties. Several alternatives exist for structuring payments to the licensor of consideration arising from sublicensing activity. One well-known industry example of this is where a patent pool or licensing administrator for the patent assets is granted the right to sublicense by the patent owner, and the licensing administrator then offers package or pool licenses to potential licensees and manages that process. Normally, a licensee may negotiate any form of consideration for a sublicense, and collect sublicense royalties directly. One alternative structure is for the licensee to report all the royalty-bearing activities of its sublicensees in its own periodic royalty report, and pay royalties on those activities as if they were the licensee's own sales. In such a mechanism, if the licensee grants sublicenses at royalty rates higher than the main license, it can keep the difference. This structure may incentivize a licensee to promote sublicenses widely, an advantage if the licensor seeks to establish the technology as an industry standard. Alternatively, the license agreement may set forth a structure for splitting any sublicense royalty revenue between the licensor and licensee according to a pre-established formula, although licensors are generally leery about reducing the royalty stream absent other market factors. For a more detailed discussion on royalties, see [Patent Licenses: Key Provisions – Patent License Payment & Royalty Provisions](#).

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In addition to his diverse experience as outside counsel, Michael has served as in-house patent counsel to Panasonic Corporation in Japan while working on secondment in Panasonic's licensing center. In that role, he acted as lead counsel in numerous third-party patent assertions and license negotiations, negotiated complex agreements, including portfolio cross-license agreements, and worked with the company to identify high value patents and strengthen their protection.

Michael also teaches as an adjunct professor at his alma mater, NYU School of Law, and has served as an adjunct professor at Seton Hall University School of Law, addressing topics such as patent and trade secret law, IP Licensing, global patent litigation, patent exhaustion, and inequitable conduct. He also frequently writes and speaks on a range of topics including IP litigation, patent monetization and licensing practices, strategic portfolio development, patent eligibility, patent exhaustion, willful infringement, patent misuse and standards estoppel, standards essential patents, damages and patent valuation, inequitable conduct, social media and privacy issues, and legal ethics.

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