



European IPR Helpdesk

Fact Sheet

Commercialising Intellectual Property: Licence Agreements

November 2015¹

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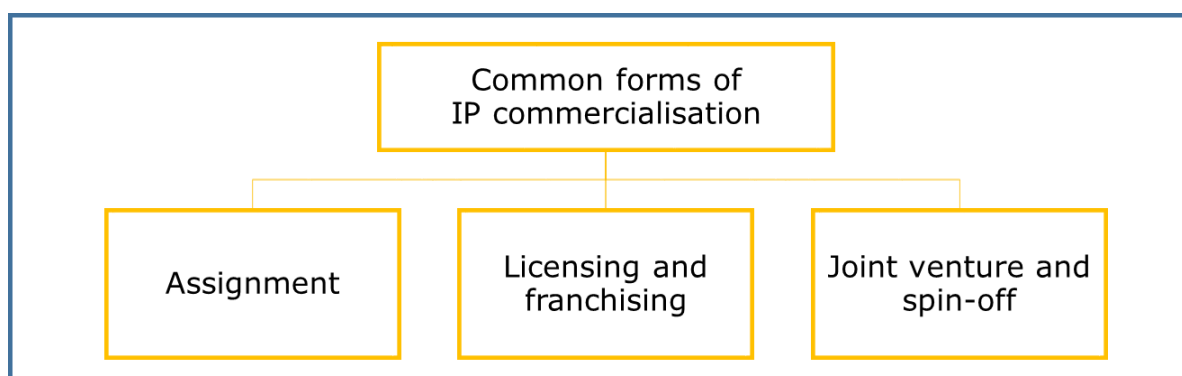
¹ This fact sheet was initially published in June 2013 and updated in November 2015.

Introduction

“Commercialising IP” is a series of fact sheets aiming to provide an introduction to the forms of commercialisation that can be useful for the less advanced public likely to be involved in exploitation of intangible assets. Content provided therein is not intended to be exhaustive, and professional advice is strongly recommended when it comes to choosing the most suitable commercialisation practice for your organisation and dealing with the complex legal issues surrounding contractual arrangements. However, with these guides we aim to give you some understanding of the basic principles, which can help you save money and time.

Commercialisation is the process of bringing Intellectual Property (IP) to the market in order to be exploited.

IP commercialisation can take different forms. The most common are summarised in the following diagram:



The financial success of any IP exploitation will certainly depend on the choice of the most appropriate commercialisation form, which should be based on:

- The organisation's business objectives
- The form of intellectual property
- The economic resources at its disposal

Risks should also be taken into account. Although the very nature of risks will depend on the type of commercialisation, their identification, assessment and management would give organisations more security.

The IP risks specific to commercialisation activities are those related to:

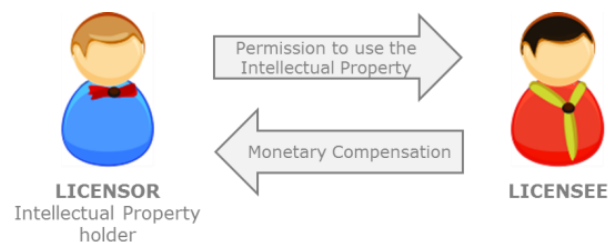
- The nature of the product and/or services
- Confidentiality
- Legal and financial matters
- Business reputation

An assessment of the risks can be based on the likelihood of the event occurrence (e.g. ownership disputes, third party infringement, etc.) and the associated consequences (e.g. irrelevant, moderate or important). Depending on the outcomes assessment, organisations will be able to make appropriate decisions about the risk management actions to be adopted (e.g. subscribing to an appropriate insurance, revising relevant clauses within contracts, etc.).

This fact sheet deals with commercial **licence agreements**. It aims to clarify when such an agreement should be used. Moreover, in this document we highlight the key provisions seen in most licensing agreements, as well as the specifics of licensing certain types of intellectual property rights.

1. Understanding licence agreements

A licence agreement is a contract under which the holder of intellectual property (licensor) grants permission for the use of its intellectual property to another person (licensee), within the limits set by the provisions of the contract. Without such an agreement, the use of the intellectual property would be an infringement. Examples of licence agreements are the software licences concluded every time you buy software or a trade mark licence permitting a manufacturer to print the logo of a company on merchandise.



Images attribution: the above diagram has been created based on the modification and elaboration of pictures taken from © Akela NDE, http://media.scoutwiki.org/File:Icon_boy_scout.svg

Typically, two types of licence may be categorised:

- (i) Licence for certain intellectual property rights - e.g. licence to reproduce and distribute a copyrighted work;
- (ii) Licence for all the IP rights necessary to reproduce, make, use, sell products based on a type of technology (technology or product licence).

1.1 When should you use a licence agreement

a) There is no transfer of ownership

Licence Agreement		Assignment
No transfer of ownership. The IP ownership is kept by the licensor. Generally a long term agreement.	DIFFERENT FROM	Transfer (sale) of the IP ownership from one party (the assignor) to another party (the assignee). One-time agreement.

b) An established organisation is allowed to exploit the IP

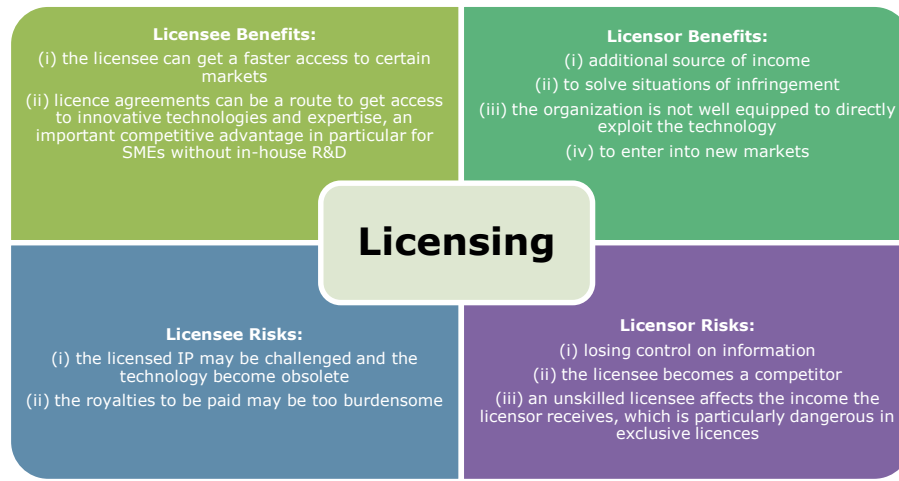
Licence Agreement		Spin-off transaction
The licence agreement does not create any new legal entity. It allows another established organisation to exploit the IP and it tends to be a long-term transaction.	DIFFERENT FROM	A small company is created with the purpose of developing a concrete technology. The licensor often assigns the IP to the spin-off company, but the transaction can also be structured through a licence of the IP.

c) The IP right holder intend to grant user rights to a third entity

Licence Agreement		Distribution agreement
It gives permission to use IP within certain limits.	DIFFERENT FROM	The holder of the technology gives permission to another organisation to distribute or sell it in a predetermined market. Commonly, a trade mark licence must be part of the contract.

1.2 Understanding benefits and risks in licensing

When negotiating a licence agreement, it is important to understand why companies licence their intellectual property or wish to become a licensee, as well as the potential risks of entering in such deal. This will not only help them to grasp the motivations behind the demands of the other party, but also enable them to mitigate risks when drafting a licence agreement and very importantly, reach a “win-win” agreement.



2. Key terms of a licensing agreement

All the conditions agreed between the licensor and the licensee should be clearly mentioned in the licence agreement, which should be in written form.

There are many options for each provision of a licence agreement, which not only depend on the parties' agreement, but also the type of intellectual property right being licensed, the sector of business and the applicable law. However, there are key provisions applicable to most licensing deals and which we intend to highlight in this section.

2.1 Background of the licence:

PARTIES

1. [name of organization], a company incorporated in [...] with the registered number [...], having its registered office at [...] (Licensor)
2. [name of organization], a company incorporated in [...] with the registered number [...], having its registered office at [...] (Licensee)

RECITALS

- (i) Licensor owns [the Patents or the Licensed Technology as defined below];
- (ii) Licensee wishes to obtain a license to [...];
- (iii) Licensor wishes to license to Licensee on the terms and conditions set out in this Agreement.

TERMS AGREED:

1. Definitions

In this Agreement, the following words and expressions shall have the following meanings:

...

2.1.1 Identification of the parties

The parties who will be bound by the contract must be clearly identified.

2.1.2 Recitals

This is the right place to state background information on the agreement, as well as the parties' reasons for entering into the agreement. Recitals might prove to be essential if a court or an arbitrator needs to interpret the licence agreement in a potential dispute.

2.1.3 Definitions

Generally licence agreements, include a list of definitions, assisting the reading and interpretation of the document. Usually, the terms are included in alphabetic order. Common terms defined in licence agreements are the following:

- a. Confidential information
- b. Net Sales
- c. (Licensed) intellectual property and technology
 - Patents, trade marks and industrial designs: usually these are identified by the elements in the title, in particular the registration number;
 - Software: the parties may include modules and version numbers and attach a copy of it to the agreement;
 - Know-how: is often defined in a few lines and described in detail in separate documentation.
- d. Territory
- e. Field of use

The technical definitions of the licence agreement, such as the *Licensed intellectual property* and *Field of use*, are essential since they have an impact on the scope of the licence, that is, what the licensee is able to do. It is crucial that the licensee understands the technology and its business needs: e.g. "What software version do we need?" "Do we need training to use the technology?"

2.2 Grant of rights

Licensor hereby grants to Licensee a [exclusive/non-exclusive] licence in the Licensed Territory to make use and sell any Licensed Products in the Licensed Field of Use.

This is the core of any licence agreement, since it is where the rights of use (and their limitations) are established. The provisions are crucial for both licensor and licensee as they establish each of them will be able to do with the intellectual property right or technology, that is, the licence's scope.

2.2.1 Type of licence

The parties should clearly indicate the type of licence being granted. Generally, there are the following types of licence²:

- Exclusive:
 - *Exclusive*: only the licensee is able to use the licensed intellectual property or technology (the licensor cannot use or license it); or
 - *Sole*: the licensor agrees not to grant any additional licenses but retains the right to make use of the intellectual property.
- Non-Exclusive: the licensee and the licensor can both use the licensed intellectual property or technology. *The licensor is also allowed to negotiate further non-exclusive licences with other companies.*

2.2.2 Rights granted

Ideally, the activities allowed by the licensor should mirror the rights granted by law as an owner of a determined intellectual property right. For instance if the copyright holder has the exclusive rights to copy the work (i.e. reproduction), issue copies of it to the public (i.e. distribution), rent and lend it, perform or show the work in public, communicate it to the public and make adaptations, the grant provision in the licence should refer to these rights.

The IP owner is free to decide to grant all or just a part of his rights as established by law. However, the licensee must carefully assess whether the rights included are sufficient for an optimal exploitation. Nonetheless, it is not always possible to clearly identify the activities allowed by reference to the rights established by law, since the licence agreement may refer to different types of intellectual property rights or cover different jurisdictions.

² The categories may differ according to national legislation and terminology.

Commonly, grant provisions can include:

- *Trade mark*: right to use and apply the Trade Mark[s] on and in relation to the [Products/Services], in connection with the [development/use/manufacture/ marketing/distribution/sale/disposal] of the [Products/Services].
- *Copyright* (including software):
 - (i) the right to use and reproduce the work;
 - (ii) the right to modify and make derivative works;
 - (iii) the right to distribute the work.
- *Patent*: right to manufacture, use and sell licensed product.
- *Technology*: develop, manufacture, practice and sell licensed technology.

2.2.3 Right to sublicense

The parties of a licence agreement need to agree on whether the licensee has the right to grant right to sublicense. There are different reasons why the licensor would be willing to grant right to sublicense and the licensee requires it:

- It may be an important additional source of revenue, particularly if the licensee may not be able to reach the entire territory covered in the licence agreement by its own;
- The licensee may be part of a corporate group and part of its affiliates can be in a better position to exploit the licensed IP.

Irrespective of the reason why the licensor is granting right to sublicense, there are a few important points to agree on and clarify in the agreement³:

- a. Is the licensee free to select the sub-licensee(s)? Some limitations may be imposed by the licensor, such as limiting the sublicenses to affiliates of the licensee or companies pre-approved by the licensor.
- b. Should the sublicense agreement establish determined conditions? Often, licence agreements impose the sublicense agreement to establish as far as possible the same terms and conditions set out in the licence agreement. In this way the licensor is able to control the sub-licensee use of the IP even though no direct contractual relation between the licensor and sub-licensees exists. This takes on special importance when a percentage of royalties comes from sublicensing revenue. Some licensors may request to receive (and even approve) the sublicensing agreement

³ See footnote 2.

with the purpose of verifying whether the terms and conditions of the licence agreement are followed.

- c. What happens in the case of the licence agreement coming to an end? There are different possibilities ranging from the immediate termination of the sublicensing agreement to the licensor's obligation to maintain the agreement with the sub-licensee.

2.2.4 Geographical scope

The definition of the territory where the licensee can exploit the IP should be clearly defined. Licences may be worldwide, cover a region such as the European Union or simply a country. This is something to be agreed on by the parties based on where the licensee plans to use the IP: e.g. the territory where a trade mark will be used, including considerations related online business activities?

2.2.5 Technical or commercial field of use

By limiting the rights granted to a concretely defined field of use, the licensee is only able to use the IP in a subset of the potential commercial uses and therefore the licensor has the right to directly exploit or license the same intellectual property for a different field⁴. For example a patent licence may limit the use of the invention to the treatment of eczema in humans.

Usually, this limitation is introduced in the licence agreement through the inclusion of a definition of Field of use, accompanied by a reference in the grant provision.

2.3 Compensation

Licensee shall pay to Licensor royalties calculated by reference to Net Sales of the Licensed Products sold by Licensee at the rate [...].

There are many reasons why the licensor may wish to establish licensing deals, but certainly one of them is to receive money from the licensee's use of the intellectual property. The determination of win-win compensation provisions will depend on the valuation made of the IP being licensed, by both licensor and licensee. Once the IP valuation is individually calculated by both parties, they are then prepared to negotiate the compensation provision and agree on the following matters:

⁴ Shotwell SL. 2007. Field-of-Use Licensing. In Intellectual Property Management in Health and Agricultural Innovation: A Handbook of Best Practices (eds. A Krattiger, RT Mahoney, L Nelsen, et al.). MIHR: Oxford, U.K., and PIPRA: Davis, U.S.A. Available online at www.ipHandbook.org.

a. *How will the licensee make the payment?*

Usually the decision is made between a lump-sum (amount determined up-front) and royalties (periodic amounts calculated on the base of the licensee's selling performance).

b. *How will royalties be calculated?*

Royalties may be calculated on the base of a percentage of the sale price, profits made or a fixed amount per each product unit sold, among others. If deductions are to be made (e.g. tax, delivery expenses) it is essential to clearly indicate them, which is often done by including definitions such as "Net Sales".

The licensee is the party that calculates royalties due in each period. It is therefore important for the licensor to introduce into the licence the mechanisms to monitor the licensee's compliance with its obligations. Commonly used mechanisms are:

- The licensee's obligation to provide the licensor with reports containing the identification of the sales that were the basis for the calculation of the royalties due in an agreed period. With the purpose of facilitating the licensor's monitoring, a template of the report can be incorporated in the licence agreement as an annex.
- The licensee's obligation to keep accurate records linked with the licensor's right to audit such documentation.

c. *When are payments due?*

Fixing the dates when royalties are due is essential in order to avoid any uncertainty.

d. *What is the currency of the payment?*

In transnational agreements it is important to define the currency of the payment. Often licensor and licensee are based in different countries with different currencies and therefore it is best practice to establish the currency to be used for payments, as well as the exchange rate.

2.4 Mitigating risks

When negotiating a licence agreement, the parties should make an effort to anticipate potential risks. There are several provisions to discuss on this matter:

2.4.1 Licensee's diligence

In particular in exclusive licence agreements, it is important that some diligence obligations are set forth for the licensee. Without such obligations, licensees could refrain from properly exploiting the technology.

The diligence obligations can be introduced by establishing a general obligation on licensee use of “best” or “reasonable endeavours”. However, given the ambiguity of such contractual promises, it is preferable to introduce in addition measurable obligations such as minimum royalties or milestones to be achieved at determined dates⁵.

2.4.2 Improvements

Concluding a licence agreement does not necessarily mean that the technology being licensed will no longer be developed. On the contrary, it is often the case that both licensor and licensee continue advancing the technology due to further research or the know-how created by the use of that technology. It is in the best interest of each party to discuss and agree on this matter, since both licensor and licensee business interests are at stake.

The common practice is to grant mirror rights, that is, each party grants rights on future improvements to the other.

2.4.3 Infringements

An unavoidable matter to discuss and agree is how to deal with potential infringements from third parties: how will these be handled? How will the licensor and licensee collaborate?

2.4.4 Warranties

Irrespective of how sound the parties’ due diligence activities are, most licensors and licensees request warranties from each other. Typical warranties seen in licence agreements are:

- a) the licensor warranty on the ownership of the intellectual property right or right to grant the licence;
- b) the licensor warranty on the validity of the intellectual property;
- c) the licensor warranty on the lack of knowledge concerning third parties infringement.

These and other warranties depend on the negotiation between the parties. What is important to remember is that the party making such statements should internally consider whether it can assume the warranties?

2.4.5 Settlement of disputes

Even though parties wish to avoid disputes, it is best practice to include in licence agreements clauses dealing with a potential future dispute among them. In this regard, there are two matters to discuss and agree on:

- The applicable law to the contract, which often is the law of the country of the licensor, licensee or where most the activities under the contract will

⁵ See footnote 2.

be carried out. Deciding on the applicable law is particularly important in transnational negotiations;

- The forum of disputes: mediation, arbitration and court⁶.

2.5 Term of the agreement

This Agreement shall commence on [the Effective Date] and, unless earlier terminated in accordance with clause [...], shall continue in force [*without limit of period or for [...] years*].

The commencement, duration and termination of the contract must be clearly stated in the agreement.

Special attention should be given to the duration of the protection of the intellectual property right being licensed, since the period of the licence cannot exceed the term of the right (e.g. 20 years for patents). This is especially important for those licence agreements where different types of IP being licensed, such as the case of a patent and know-how licence agreement, since they could have different duration periods. In such cases it is advisable to clearly differentiate the two licences, particularly if the parties wish to maintain the know-how licence in force after the expiration of a patent.

2.6 Miscellaneous

Licence agreements are contracts and therefore the principles of contract law apply. Consequently, when drafting such contracts the parties are advised to include provisions dealing with, for example, confidentiality and breach of contract among others.

3. Specificities depending on the intellectual property involved

3.1 Specificities of trade mark licences

The Licensee shall during the term of the Agreement use the Trade Mark only in the [form and style in which the Trade Mark is registered or form, colour, design, style and manner directed or approved by Licensor in writing from time to time].

The Licensee shall during the term of the Agreement ensure that all manufacturing, packaging, storage, marketing and supply operations of the [Goods or Services] are conducted consistently with good practices and in accordance with the specifications communicated by Licensor from time to time.

The Licensor shall have the right to inspect the Licensee's premises and to take samples of any Goods sold or to be sold in association with the Trade Mark.

⁶ See fact sheet Alternative Dispute Resolution Mechanisms, available in our [library](#).

Quality control provisions are the core of trade mark licences since they ensure that the consumers are not confused by the licensee's use of the trade mark. In fact, these provisions aim to guarantee a consistent use of the trade mark and therefore that the consumer always gets the same level of quality of the product or service. Without such provisions, the licensor may lose its trade mark.

Typical quality control provisions establish obligations concerning the licensee's usage of the trade mark, often by referring to specifications or documentation where the licensor prescribes the standards to be met. Additionally, measures for monitoring of the correct usage of the trade mark by the licensee are commonly included in the agreements, such as the licensor right to inspect the licensee's facilities and the right to receive samples of the finished products⁷.

3.2 Specificities of copyright licenses

Copyright licence agreements can include escrow provisions, through which the licensee is granted with the possibility to access physical copies of the work (e.g. sound recording or movie) or the software's source code⁸.

Through such a provision, the parties agree that the master copy of the work or the software's source code is deposited in confidence with a third party, who can only release a copy to the licensee if determined events occur, such as the licensor's bankruptcy. In this way, the licensor guarantees that its most valuable assets are not disclosed to the licensee and the latter mitigates the risk of losing its ability to keep producing copies or improvements.

4. Negotiating a licence agreement

4.1 Preparing for a licence agreement negotiation: preparatory contracts

Licensing agreements are usually long term business partnerships. The licensor and the licensee continually interact for a determined period of time, both dedicated to a profitable use of the intellectual property. It is therefore common that before entering into such an agreement, it is often appropriate to start the relationship with preparatory agreements, such as non-disclosure agreements or material transfer agreements among others.

4.1.1 Non-disclosure agreement

Non-disclosure agreements (NDA) are legally binding contracts establishing the conditions under which one party (the disclosing party) discloses information in confidence to another party (the receiving party). All types of information can be disclosed under these agreements, such as ideas, know-how, descriptions of

⁷ *Secrets of Intellectual Property: A guide for small and medium-sized exporters*, International Trade Centre UNCTAD/WTO and World Intellectual Property Organization, 2003.

⁸ *WIPO Guide on the Licensing of Copyright and Related Rights*, World Intellectual Property Organization, 2004.

inventions, chemical formulas, research or business information and negotiations, among other. The common characteristic though is that the disclosed information is valuable for the disclosing party to the extent that it must be kept away from the public domain.

By signing a bilateral NDA, prospective licensors and licensees therefore guarantee that their secret and valuable information is kept in secrecy and is not misused⁹.

4.1.2 Material transfer agreement

The main objective of concluding a material transfer agreement (MTA) is to regulate the exchange of proprietary material to be used by the recipient for research or for evaluating whether the material works well in its facilities¹⁰. MTAs are therefore often used, particularly in the health sector, as a preliminary agreement before deciding to enter a long term licensing agreement.

4.2 Due diligence

Licence agreements are complex deals requiring both parties to engage in due diligence activities, particularly IP due diligence¹¹. The main objective is to reduce risks, mainly concerning IP ownership and strength. Yet, risks cannot be completely eliminated by due diligences and therefore provisions concerning warranties should be seen as a complementary tool towards risk mitigation.

<i>What the licensor needs to know?</i>	<i>What the licensee needs to know?</i>
Business and licensing experience, with the purpose of understanding whether the licensee is capable of successfully exploiting the intellectual property	The licensors' rights on the intellectual property: what is the ownership chain? What is the term of the right? ¹²
Assessing the value of the intellectual property right being licensed is a determining factor for both parties. The value will determine the compensation for the licensing deal.	

⁹ For further information on NDAs, we suggest you to consult the fact sheet *Non-Disclosure Agreement: a business tool*, available in our online [library](#).

¹⁰ Mahoney RT and A Krattiger. *Agreements: A Review of Essential Tools of IP Management*. In *Intellectual Property Management in Health and Agricultural Innovation: A Handbook of Best Practices* (eds. A Krattiger, RT Mahoney, L Nelsen, et al.). MIHR: Oxford, U.K., and PIPRA: Davis, U.S.A. Available online at www.ipHandbook.org.

¹¹ For further information on due diligence, we suggest you to consult the fact sheet "*IP due diligence: assessing value and risks of intangibles*", available in our online [library](#).

¹² Performing searches in IP databases is essential to determine the licensor rights. For further information on patent and trade mark searches, we suggest you to consult our fact sheets on how to perform searches, which are available in our [library](#).

5. Registration of the licence agreement

In some countries certain types of licences, such as exclusive patent licences, must be registered in a national registry, usually at the Intellectual Property Office¹³. If registration is not performed by the parties, the agreement does not have legal effect or the licensee may lose some rights, such as the right to damages or to request an injunction in case of a third party infringement. Licensees, in particular, should consider this obligation.

Useful Resources

For further information on the topic please also see:

- *Exchanging Value – Negotiating Technology Licenses, A Training Manual* published jointly by the World Intellectual Property Organization (WIPO) and the International Trade Centre (ITC):
http://www.wipo.int/sme/en/documents/guides/technology_licensing.html
- *Licensing Intellectual Property*, published by the UK Intellectual Property Office: <https://www.gov.uk/government/publications/ip-health-check-licensing-ip>

GET IN TOUCH

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¹³ To find the contacts of EU Intellectual Property Offices, we suggest you to consult [INNOVACCESS](#).

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The European IPR Helpdesk aims at raising awareness of Intellectual Property (IP) and Intellectual Property Rights (IPR) by providing information, direct advice and training on IP and IPR matters to current and potential participants of EU funded projects. In addition, the European IPR Helpdesk provides IP support to EU SMEs negotiating or concluding transnational partnership agreements, especially through the Enterprise Europe Network. All services provided are free of charge.

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Website: On our website you can find extensive information and helpful documents on different aspects of IPR and IP management, especially with regard to specific IP questions in the context of EU funded programmes.

Newsletter and Bulletin: Keep track of the latest news on IP and read expert articles and case studies by subscribing to our email newsletter and Bulletin.

Training: We have designed a training catalogue consisting of nine different modules. If you are interested in planning a session with us, simply send us an email at training@iprhelpdesk.eu.

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