

## Dartmouth Entrepreneurial Network

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### Your First Licensing Deal: The Ins and Outs of Licensing Agreements

by Billie Munro Audia, Zermatt Legal Group



After 22 months of perfecting your product, minimal income and pounding the pavement, Big Company AZTEC is interested in licensing your product. They confirm by email that they will *“handle manufacturing, marketing, and distribution and pay a sales royalty if you sign the AZTEC standard licensing agreement.”*

Is this your big break? All you need to do is sign their license, sit back and collect royalty checks, correct? The reality will depend largely on what kind of company Aztec really is, the terms of the licensing agreement, and, of course, on AZTEC (and your) execution.

This article is the first in a two-part series on licensing agreements, written to help you decipher licensing terminology and recognize a few of the “red flags” common in big company licensing agreements.

#### The License Grant Provision

The license grant provision is one of the most critical in any licensing agreement and it is commonly called the “Grant of Rights” or “Licensed Rights”. This provision specifies the rights, which you (the licensor) are granting to the licensee concerning your product. It generally includes a list of what the licensee may (and may not) do with the product, for how long and in what geographic location(s). The scope of the license grant may be as broad or as narrow as the parties determine.

**Red Flag Tip:** The following terms are license grant red flags: perpetual, exclusive, irrevocable, and global.

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Perpetual means always and forever, oftentimes including after the agreement terminates, which is a long time to be tied to a new business partner. A better business strategy may be to strike "perpetual" and opt for time bound licensing periods with incentives to extend the term (e.g., "if licensee achieves XYZ milestones within ABC timeframe, the license will be extended for an additional two-year term"). This allows you to see how AZTEC performs against an objective metric before you commit to them for the long-term.

Exclusive means AZTEC will be your one and only licensee, so you may not license the product to others even if AZTEC sits on it for a decade. In addition, some exclusivity provisions may prohibit the licensor (you) from distributing or selling the product. While this may work for your business model if you charge an appropriate, up-front premium fee, in most cases it is best to either strike "exclusive" from the grant language or time bound the exclusivity period.

Irrevocable means that whatever AZTEC does, you may not revoke their license to manufacture or sell the product. For example, this could prove to be damaging to your product's reputation if they are manufacturing it carelessly and it also leaves you little leverage to force them to change. It is generally best to strike "irrevocable" from the license grant.

Global means all territorial locations. While this may be fine in certain circumstances, if this is your first deal with a particular licensee, a more strategic business approach may be to first see how they do with North America rights and then consider extending the license to other territories.

IP-related terms in the License Grant. The language used in the license grant provision should "match" the type of intellectual property (IP) you are licensing. License grant language specific to patent-protected products usually includes the right to "make", "use" and/or "sell". For example, if you are licensing rights to a patented pharmaceutical, you would license the right to manufacture and sell a product that uses your patented pharmaceutical to a drug company. License grant language specific to copyright-protected works usually includes the right to "reproduce, transmit, distribute and prepare derivative works." For example, if you are licensing your source code to a software company, you may license the right to reproduce and distribute your code embedded in their software. These rights

may be carved up geographically as well. So if you are licensing rights to reproduce and transmit your company's catalog of music videos, you could license the UK rights to Kensington On-Demand Portal and the North America rights to Hanover Cable.

**Red Flag Tip:** Watch out for license grant language that allows the licensee to "make improvements to" or "create derivatives of" the licensed product. If such an arrangement works for your business model, then it is advisable to include a broad, royalty-free, "grant back" provision, which will allow you to use, manufacture and sell the licensee-made improvements or derivatives at no cost.

Excluded Rights. In addition to specifying what the licensee may do, the license grant may also describe which rights are excluded. This may be done with a catch-all provision (e.g., "AZTEC may only exploit the rights specified herein") or with narrow exclusionary language (e.g., "AZTEC may not distribute the product in Japan"). Together with your business lawyer, consider what is best for your business, keeping in mind any rights you may have already licensed to others and those you want to retain.

Retained Rights. The license grant may also state which rights the licensor retains. In most cases, the licensor will want to keep some rights to the product, including ownership of the IP. So you may want to consider including language similar to: "licensor is and shall remain the sole and exclusive owner of all intellectual property rights to the product."

**Red Flag Tip:** License grant language that "transfers" or "assigns" IP to the licensee essentially creates what is tantamount to the licensee owning your IP. So watch out for language that transfers or assigns the IP to the licensee and consider striking it from the license grant.

Hopefully this overview of licensing grant language and related red flags will be helpful when you negotiate your first licensing agreement with Big Company. The second article in this series will guide you through additional licensing terms, such as marketing and royalties. Please do not consider the content of this article as legal advice and always consult with legal counsel before signing any agreements.

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