Intellectual Property Licensing for the Purposes of the Technology Transfer Block Exemption Regulation (TTBER)

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1 Introduction

Interaction between technology licensing and EU Competition rules drastically changed seven years ago. Before this change in approach, applying competition law rules to licensing agreements was a relatively simple matter of identifying restrictive provisions of the agreement and proofing them against a block exemption regulation. There was no need to fully understand the competition policy or mechanics of Article 101 TFEU[1]. It all changed when the Commission decided to modernize its approach, which ended in adoption of Technology Transfer Block Exemption Regulation (TTBER) and extensive guidelines related to licensing agreements.

In order to give a full picture on this interaction the paper will examine in detail how and why intellectual property rights [hereinafter IPRs] are being licensed, what kind of licenses exist, and what the key issues in licensing IPRs are. Because the focus is on block exemption regulation and the hardcore restrictions therein, only the four IPRs that the TTBER applies to, will be analyzed.

Since the vast majority of scholarship globally that cover the issues related to interaction between competition rules and intellectual property rights licensing, turn immediately to the very core of the problem (hardcore restrictions in the agreement, position of the contracting parties, reduction of dynamic efficiency etc.) there is a need for scholarship that outlines the starting point and assumptions underlying the aforementioned issues and thoroughly guides a less IP-educated reader of such materials into the area with less difficulty. One must keep in mind that the Commission's concern is aggravated regarding IPRs, due to the fact that they are territorial in their nature (the content of IPRs in one country is determined by the law of that country and effective only within that jurisdiction), which makes their exercise inherently restrictive of the free movement of goods in the

[1] Article 101 prohibits as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market;and any such agreements or decisions prohibited pursuant to it shall be automatically void.

Third paragraph of Article 101 exempts:

— any agreement or category of agreements between undertakings,

— any decision or category of decisions by associations of undertakings,

— any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

internal market. The inherent contradiction between free trade and IPR protection has been recognized globally. The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS)[2], which is administered by the World Trade Organization, sets forth minimum standards for protection of IPRs for WTO Member States, thus leveling the playground for holders of IPRs and other players on the market.

2 Why license?

The holder of intellectual property right is permitted to preclude third parties from using and exploiting the subject matter protected by these rights. This means that IPRs are exclusionary property rights, which differ from other forms of property rights by the fact that they are intangible. The economic justification for these types of property rights that confer a legal monopoly on their holders (to exclude others from using these rights) is to resolve the problem of „free riders". Basically, if everyone were to use the invention freely, there would be no incentive to innovate. All market actors would wait for someone else to invest in invention, and then simply copy the final product, once it is placed on the market. Such free-riding would create a significant blow to the free market economy, which heavily relies on innovation. Another argument in favor of IPRs and the legal monopoly created is that throughout the history, some sort of innovation protection system, starting from the point where the country starts do develop its own industry, seems to be required for development to take place.

> A striking feature of the Industrial Revolution is that, it is easily demonstrated that the countries with high level of protection for patents had a higher level of industrialization than the countries that refused to grant patent protection, or granted only weaker form of protection.

Thirdly, it is argued that protection of IPRs and granting a monopoly to the inventor represents a reward for the innovator, since there is, as reward theory states, a moral responsibility for a society to reward the inventor. However, the exclusive monopolistic character of IPRs is coupled with the fact that they are transferable, as well as marketable. Not every inventor is able to exploit his invention economically, which requires not only inventing the process or the idea, but transforming it to the final product incorporating that idea. That is why licensing plays an important role in the free market economy, and industrial world in general. A license agreement usually takes the form of a written contractual arrangement between the holder of IPR (the licensor) and another party (the licensee), who wishes to obtain a legal permission from the licensor, either to operate within the bounds of the licensors IPR, or to exploit the licensors technological innovation which is protected by

[2] *See* Resource Book on TRIPS and Development :An authoritative and practical guide to the TRIPS Agreement available at: http://iprsonline.org/unctadictsd/ResourceBookIndex.htm , last visited November 20, 2011.

IPR.[3] Simply stated, a license is a permission granted by the licensor to the licensee, to do something, that the licensor has the right otherwise to prohibit. It represents an authorization, by the owner of the IPR to the licensee to use the rights under certain conditions and limitations without the fear of being sued.

Still the biggest incentive for licensing IP is financial gain, since licensing creates revenue. Most licenses bear royalties, either in a form of a lump sum, or as running royalties (periodic payments based on the number of sales of items incorporating IPR). Even in cases where a license does not bear royalties, still it can create cost savings by means of cross-licensing (plainly, an exchange of licenses between two holders of IPRs), in which case there is no need to pay cash royalty, and therefore, the license still creates income. Another important incentive for licensing is penetration of new geographic and product markets. An IP owner may authorize a licensee to enter into a geographic (or product) market not currently served (or offered) by the licensor. Not only does a licensor receive an income in a form of royalty payment by the licensee, but also he gets the chance to monitor the success of the licensee in the given market, and if it proves that licensee is successful, the licensor can enter the market as well. In certain cases, the right holder is only able to offer a limited product line, and there licensing provides for variety and range of choice in the market, which serves to increase the interest of the basic product. Licensing has the effect of strengthening the licensed property, since the recognition by others of the validity of patent rights, as evidenced by the presence of licensees paying royalties, is deemed by the courts to be a "secondary indicia of patentability", and the more licenses are granted, the stronger the licensed patents become.[4]

Now that we have seen why one should license in the first place, it is important to briefly deal with the types of different IPRs that can be licensed. It is important to note that every type of IPR is eligible for licensing. However, since this paper deals with the impact of IP licensing on EU Competition Law and the treatment of licensing agreements in Technology Transfer Block Exemption Regulation[5] [hereinafter: TTBER] and Technology Transfer Guidelines[6] [hereinafter: TT Guidelines] only „core" technologies shall be dealt with in this paper. There are four core technologies according to the TTBER and TT Guidelines: patents, know-how, design rights and software copyright.[7]

[3] Duncan Curley, Intellectual Property Licences and Technology Transfer, Chandos Publishing, New Hampshire, 2004, at 4.

[4] Alexander I. Poltorak and Paul J.Lerner, Essentials of licensing intellectual property, John Wiley & Sons,Inc, Hoboken New Jersey, 2004, at 3-4.

[5] Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements

[6] Commission Notice – Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (2004/C 101/02)

[7] Article 1(1)(b) and 1(1)(h) of the TTBER and para 46 of the TT Guidelines

Patent gives its owner the right to prevent others from producing, using, selling or importing the patented invention. It is a set of exclusive rights given to the inventor by the state in exchange for disclosing the invention. In order for the set of rights to be given to the inventor, the invention usually has to be novel, it requires the invention to be industrially applicable and the existence of inventive step is crucial. Important thing about the patent is that they are national by their nature, which means that they usually only have effect in the issuing country.

> For the purpose of the TTBER, according to the Article 1(1)(h) patents means: patents, patent applications, utility models, applications for registration of utility models, designs, topographies of semiconductor products, supplementary protection certificates for medicinal products or other products for which such supplementary protection certificates may be obtained and plant breeder's certificates.

Know-how according to the TTBER means a set of non-patented practical information, resulting from experience and testing, which is secret, substantial and identified.

> According to Article 1(1)(h) secret means not generally known or easily accessible, substantial means significant and useful for the production of the contract products, and it is identified if described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfills the criteria of secrecy and substantiality;

It comprises of body of information, parts of which may be known individually, but the compilation is secret, and therefore has a competitive value. The fact that the information is not publicly available confers the competitive advantage on its possessor. For example, it may be a manufacturing process or a chemical formula, or even a business method. Know-how is potentially immortal, and its life extends as long as the information is kept secret. Once the information is disclosed, the know-how ceases to exist. In this area lies the most important difference between know-hows and patents: if already patented invention is rediscovered and practiced by an independent inventor, that inventor will still be an infringer of patent. If know-how is rediscovered lawfully (i.e. by reverse engineering), once it is known, the protection is lost.

Starting from 2004, the Commission has decided to include **designs** to the core technology group, by defining it under the scope of patent. Industrial design is a combination of applied art and applied science, whereby the aesthetics, ergonomics and usability of products may be improved for marketability and production. The role of an industrial designer is to create and execute design solutions towards problems of form, usability, physical ergonomics, marketing, brand development and sales.[8]

Software copyright represents an extension of copyright law to machine-readable software. Software copyright is commonly used by proprietary software companies to prevent unauthorized

[8] Jocelyn de Noblet., Industrial Design, A.F.A.A. , Paris, 1993

copying of their software. Transfers of technology frequently include software programs showing methods for production and processing. The computer software envisaged as core technology is included for the primary purpose of assisting in production of the contract products and can be contrasted with the software license that accompanies shrink wrapped software sold purely to consumer.[9]

> TT Guidelines clearly state that the TTBER only covers the licensing of other types of intellectual property such as trademarks and copyright, other than software copyright, to the extent that they are directly related to the exploitation of the licensed technology and do not constitute the primary object of the agreement. This condition ensures that agreements covering other types of intellectual property rights are only block exempted to the extent that these other intellectual property rights serve to enable the licensee to better exploit the licensed technology.

When it comes to licensing IPRs, legal practice differs between "the carrot" and "the stick" licenses. A license taken voluntarily by the party is what is commonly known as a carrot license. The owner of the IPR has attracted the licensees into taking a license by showing them the benefits to be realized by the usage of property, and the user has decided to take „the carrot" and adapt and utilize the property. This represents an amicable way of licensing, unlike the stick licensing where the parties are „punished" by being obliged to take a license, usually after being caught infringing other party's IPRs. After one is caught infringing IPRs, the owner of the rights can, under the threat of a legal action taken against the offender, make the infringer take the license, and of course pay the royalties for using the IPR. In case that an offender declines to take the license, the owner of the infringed property can always „beat the offender with the stick of his IPRs". It is easy to understand why stick licensing is more profitable and less difficult to accomplish. Carrot licensing requires a licensor to acquaint the licensee with the IPR, its appeal and desirability. This step is already taken in stick licensing even before the parties have made contact (it is not even necessary that the owner of IPR is involved in the first step at all). No effort is required by the property owner in relation to the offender up to this point, since the offender has not only educated himself on the benefits and advantages of the property, but has already committed himself to use it.

> The offender has already invested in production facilities, specialized equipment is most likely purchased, and advertizing materials are prepared. This puts the infringer in a very bad negotiating position, since unless he accepts the stick license, all of his efforts done previously will be in vain.

Now that we have discussed two basic licensing strategies, it is important to examine the different types of licenses that exist. An **exclusive** license provides that the licensor shall not grant additional

[9] Steven D. Anderman and John Kallaugher, Technology Transfer and the New EU Competition Rules Intellectual Property Licensing after Modernisation, Oxford University Press, New York, 2006 at 295

licenses for the given territory to other parties, as well as exploit the licensed IPRs himself. This basically means that the licensee will be able to exploit the license on the given territory on exclusive basis, without anyone else operating with the licensed IPR in the area covered by the license. It is commonly thought that through exclusive license all of the licensors rights apart from ownership of the IPR are transferred to the licensee. However, some licenses, known as **limited exclusive** licenses are only limited in certain aspects.

> For instance, a license may be exclusive only for a certain period of time, and then it becomes non-exclusive, or a licensor can impose certain restrictions on a licensee in regards of field of use of the given license (i.e. new patent on improved automobile transmission, which is only to be used in engines with less than 220 horsepower).

The largest part of exclusive licenses are carrot licenses, since they require a potential investment and risk taking on behalf of the licensee, which makes him reluctant to make the investment, unless protected at least for a certain period of time. The CJEU has made a distinction between different types of exclusive licenses in *Nungesser (Maize Seeds) case*[10].

> INRA (French National Institute for Agricultural Research) developed new strains of hybrid maize seed, and later gave Nungesser KG the exclusive right to produce and distribute varieties of the seed in Germany, agreeing not to import the seed in Germany itself, and to prevent others from doing so. Nungesser KG used such rights to stop parallel import of seed in Germany from another source in France, and one importer complained to the Commission, which found that exclusivity and territorial protection were caught under Article [101(1)], so Nungesser KG appealed to the Court of Justice.

The Court distinguished between an **open exclusive** license, which relates only to the relationship between the licensor and the licensee, whereby the licensor agrees not to grant any further licenses on that territory and not to operate there itself, and on the other hand, **closed exclusive** license that contains provisions which affect third parties and create absolute territorial protection.

Non-exclusive license exists where the licensor remains free to grant other licenses for the territory assigned to the initial licensee, or if it wishes so, can exploit the IPR in that territory itself. A **sole** license is the license where the licensor agrees not to license other licenses on the territory reserved for the licensee, but remains free himself to exploit the given area. The IPRs can therefore be exploited by the licensor, licensee and no-one else.

As expected, most of the licensees would like to have a monopoly in the licensed IPR, and would pay extra to obtain it. The result of this is that the exclusive license will require a higher price of the same licensed property than the non-exclusive one. This higher price, doesn't mean that the licensor will always strive to grant the exclusive license, since it only includes a single royalty (even if it is a

[10] L.C. Nungesser KG and Kurt Eisele v Commission of the European Communities. - Case 258/78. European Court reports 1982 Page 02015 at para 53

running-royalty) while with the IPR licensed to more than one licensee on a nonexclusive basis, gives the licensor more than one source of income. It seems at first that the licensor is faced with the trade-off between the higher income secured through the exclusive license, and a number of lower payouts secured through the number of non-exclusive licenses for the same property. However, this is a simplified way of looking at things since the licensor is in fact, while granting an exclusive license, putting all his eggs in one basket. If the exclusive licensee breaches the contract, faces bankruptcy or any other interruption of his business occurs, the licensor is faced with the loss of the income deriving from the exclusive license.

Now that we now basic principles and definitions required to better understand the process and motives for licensing, it is time to turn to the licensing agreements in more detail. Since this paper will deal only with the core technologies according to the TTBER and TT Guidelines, patent (as well as design rights categorized as patents in the TTBER) know-how and software copyright licenses only, shall be dealt with in detail.

3 Patent license

While drafting a patent license, a draftsperson in charge will at least have to give three basic definitions: licensed patents, licensed territory and licensed products. Of course, depending on the circumstances, more than these 3 basic definitions can be included, but without these, the license would be obsolete. Licensed patents are those patents which are subject to the license. A license can be composed of one or more patents. In addition to the patents enumerated in the definition, it is common to include the phrase „and any continuations, divisions and reissues thereof“, which is intended to make sure that any further patents arising out of the patent application that mature into the enumerated patent are included in the license, along with any patents resulting from the correction of any enumerated patent (reissues). Licensed products are products that may be produced, used and sold by the licensee under the terms of license. On one hand, the licensed product can include all products covered by one or more claims of the licensed patent(s). Situations where the licensee discards that the product is covered by the licensed patent claims (and by doing so, avoids paying the royalties), can easily be avoided by including a list of products (when known) with the words „including but not limited to the following products“ in the contract. On the other hand, the licensed product can comprise only of a single specified product. After discussing what is licensed and how it may be used, the third crucial point is defining where it may be used. Territory may be defined quite broadly, for instance EU wide, or in the territory of a several countries, but also it can be defined narrowly, like for instance, a single location, such as licensee‘s business premises (in which case an address is included).[11]

[11] See Poltorak and Lerner supra note 3. at 54-56

It is important to note that the rights secured by the patent need not be licensed altogether, since the licensor can allow a licensee to produce the patented invention and use it himself, but not to sell it.

> Contract law plays an important role in this aspect of license agreements, since in countries whose legal systems accept the concept of "implied license", these kind of clauses are de facto limited by the courts. If for instance, a licensee could obtain a license to produce the goods, but not to use or sell them, in case that this license would end up in court litigation (and it most certainly would), the court would include in the license at least a right to sell the product (if it could be implied that the licensee is in business of manufacturing and selling similar type of products, and that was the purpose of entering in the agreement in the first place).

One important privilege of exclusive licenses is the fact that the licensee gets *locus standi* to sue against infringements of the licensed property. Thus, this feature of exclusive licenses should be borne in mind when drafting the contract and granting rights to the licensee. The other privilege that can be granted to the licensee is permission to sublicense, which is a privilege that has to be tightly controlled. Another very important part of licensing agreements are patent marking provisions. In order for the patentee to claim damages from an infringer, the infringer has to be notified of the ongoing infringement. Once notified, the damages accrue from the date of the notice. Notice can be actual (i.e. letter from the patentee, in which it states that the patent covers the products, and of course identifies the patent), or constructive. Constructive notice consists of labeling the patented product with the patent number. If there is no patent number, and the product is commercialized, damages in respect of the infringement begin to accrue only when the infringer is placed on actual notice.

> This labeling requirement also applies to the licensee, since his failure to do so has the same effect as the failure to mark the product by the patentee. This is the main reason why most of the patent licensing contracts also have a clause related to patent marking.

Since the licensee is paying for the usage of the patent, in case of an infringement, he will ask the licensor to make certain actions in order to stop the free-rider issues. Two of the most likely ways to do so are to stick license the infringer (which is in case of an exclusive or sole license a problem for the licensor, since it will have problems licensing the second licensee for the territory already exclusively assigned to the first licensee) or to enforce a patent against an infringer. „[According] to the 2003 Report of Economic Survey published by the American Intellectual Property Lawyers Association, the average cost of patent litigation is $2M, trademark litigation is $600K, and other types of IP litigation average between $500K and $800K." [12] Since the costs of a patent litigation are so high, in situations where the infringement act is a *de minimis* act, it would not be economically

[12] William J. 'Bill' Robinson, IP Litigation Strategies: Patents: Markman Hearings - Part 2, Foley & Lardner LLP, Los Angeles, CA, FindLaw, September 30, 2003

beneficial for the licensor to start a patent litigation procedure. For such reasons, it is common in a patent license that a licensor abstains from granting a licensee the right to decide when an infringement action will be started. This goes against the licensee‘s interests, since the payment of royalties is entitling him to freedom without an unlicensed competition, which thus makes it the obligation for the licensor to sue immediately after the infringement is being known.

> As a mean of motivating the licensor to sue promptly, a contract can stipulate that no royalties will accrue while the infringement continues. In order to sue the infringer only the licensor has the standing (or in a case of an exclusive license, the licensee can sue as well). In non-exclusive licenses the licensees can only join the patentee as claimants.

A potential licensee will almost always demand the warrant that the patent(s) in question are valid and enforceable, and that the use (sale, production and everything else that has been agreed upon for the Licensed Patent) of protected property right will not infringe the rights of a third party. In the practice of patent licensing, it is known that sometimes licensees seek to include in contract a warranty that the licensed patent will not infringe any of the third parties rights. Such thing is in most cases a tremendous burden for the licensor, since it is virtually impossible to be certain of the validity of the patent. The second warranty includes not only domestic patents, but foreign patents and previous publications and public activities, all of which are most likely unknown to the licensor, most of the patentees can only offer a representation that they are unaware of the prior art in the present time. The licensee can even go further by demanding a warranty that the licensor has no other patent which could be potentially infringed under by licensee actions according to the license, and this demand, unlike the previous one is most likely to be met by the licensor.

If a patentee would attempt to license a patent beyond its term, it would clearly represent an abuse of patent, and attempts like that are capable of rendering the patent unenforceable. Of course any shorter period would be allowed. In most patent licenses the term is set to the expiration of the patent, and in cases where there are multiple patents merged in a single license, the term is set to the expiration of the last patent to expire.

> This can be quite different in cases of exclusive licenses (where the licensor has transferred on a licensee the right to sue the infringers of a patent) where the term can be set even after expiration of patent, to allow the licensee to finish the litigation he already started. In such cases, it is important to mention that the royalties stop to accrue upon the expiration of the patent.

It is possible that the patent license is terminated before the end of its term. This situation arises when one of the parties has breached the license agreement materially and has failed to cure the breach on time (after a notice by the party that did not breach the agreement). What happens in situations that arise out of the breach of contract can be agreed upon in the „Termination“ part of the agreement. Provisions typically found in „Termination“ part of the agreement are those

pertaining to the disposal of any inventory of Licensed Product on hand when the license is terminated. Most commonly, the licensee is allowed to sell any such inventory, complete any work in process, and fill any existing contracts, subject to the obligation to pay the appropriate royalty.[13]

The overturning of patents is not uncommon, because patent-issuing offices lack the resources to thoroughly examine every patent application and therefore rely on private-party court challenges for an in-depth examination of important, but questionable patents that are issued. Commercially significant patents are often declared invalid or restricted in important ways. A typical source of invalidity is the existence of prior art that causes the patent to fail the novelty requirement. Thus, patents do not always grant secure property rights to the patent holders.[14] What effect has this situation on the license? It basically depends on whether the license is to a single patent or to a multiple number of patents. In a single patent license, the invalidity or unenforceability of the patent would result in termination of the license, which would relieve the licensee from paying the royalty. In a multiple patent license however, where the invalidity of the patent affects less than all the patents licensed, the answer is not so simple. The license itself is usually not terminated (unless explicitly stated so in the termination clause of the agreement), but it continues to remain in force concerning the still valid patents. This complicates the question of royalties, especially if running royalties were agreed upon. There is a possibility that they remain the same, or that they are reduced, and for such reasons, the invalidity or unenforceability clause is usually part of the agreement, the absence of which always leads to a litigation.

Finally, every decently drafted patent licensing agreement will address the issue of improvements. A licensee may request that any improvement made by the patentee on the patent in question is included in the license. Usually, these requests are nothing uncommon in patent licensing, but they also frequently contribute to a raise in the royalty rate. Even though economically, it makes perfect sense that the licensee (in the case of sole or non-exclusive license) should be able to compete with the licensor or other licensees in situations where additional improvements are made, licensors are sometimes reluctant to grant these improvements for free. This is usually the case in paid-up licenses, where a lump sum is paid up in front, and no running-royalties are included. On the other end of the rope is the situation where the licensee makes certain improvements on the licensed property (all of which, of course, he is free to use). In most of those situations, the licensors were eager to ask for the licensees to assign any of those improvements back to them. Since such grant-back clauses in a number of cases contravene competition law, licensors are now merely stipulating for a non-exclusive license of any such improvements.

[13] Poltorak and Lerner supra note 3. at 63

[14] James J.Anton and Dennis A.Yao, Patents, Invalidity, and the Strategic Transmission of Enabling Information, Journal of Economics & Management Strategy, Jun2003, Vol. 12 Issue 2, at 154

4 Computer software license

The licensing of software is different from licensing any other form of intellectual property rights, because it encompasses not only the underlying technology but the program or "the product."[15]The specificity of software which makes it different from other forms of IPRs that are being licensed, is that it is sold directly to the user, rather than being licensed. Another issue regarding the software license is that these kinds of licenses are rarely negotiated (but are rather in a form of a shrink-wrap contract). In case that there is an opportunity to negotiate a contract for a software license, four issues are paramount: the scope of use, performance guarantees, termination provisions, and indemnification.[16]

The basic purpose of a software license is to increase the sales of the computer software in question. The problematic nature of software is that as a product, it is intangible, which basically means that after only one copy has been obtained, the user can merely give the software to someone else, multiply it, or rent it to others. This is the reason why the scope of the computer software license is highly specific when it comes to the intended use, the place of use, and most importantly, number of users. If the license allows the software to be installed on the computer network, usually the number of network users is specified (the royalty rate depends on this number). As mentioned before, the computer software that is considered a technology transfer for the purposes of the TTBER is used for production and processing, which makes the licensee‘s business depending on it.

> It is the attitude of the Commission that the TTBER applies only to agreements between two undertakings concerning the licensing of technology for the purpose of the production of contract products. This is particularly important is software licensing, since only those types of computer software licenses that are related the production of specific products can benefit from the block exemption.

In case of an unexpected loss of the license, the licensee would find himself in serious problems. That is the reason why many licenses include termination provisions, which provide for a grace period, during which they can find an alternative for the software previously used, and in exchange licensors usually demand audit provisions which could help the detection of any violation of the license restrictions, and also quite usually severe damages are stipulated.

It is easy to understand how and why is the software indispensable for the operation of the licensee‘s business, and the failure of the software could have detrimental effect on the licensee. When negotiating the license, licensors do their best to limit their responsibility and exposure to such events. Since most likely the disclaimer of all damages could not be negotiated (or enforced by

[15] See David A. Rice, Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine, 1990, 30 JURIMETRICS J. 157, at 166-72 (discussing how the inapposite nature of software licensing differs from other established forms of copyright-related licensing)

[16] Poltorak and Lerner supra note 3. at 92

almost any court in the world), the next best thing the licensors usually do, is try to exclude consequential damages and limit a licensee‘s recovery to the amount paid in royalties or license fees. Frequently, the licensors will try to limit their responsibility to the performance of the licensed software, by disclaiming any warranties that is fit for any particular purpose. In case these warranties are disclaimed, the computer software only needs to be one of „merchantable quality“ (which means that it only needs not to be a piece of rubbish). This is the reason why licensees of customized software (software adapted for special purposes) should be particularly careful to these warranty provisions, and if possible try to ensure that the license specifies the performance criteria for the licensed software, and that the licensor warrants that the software will meet these criteria.[17]In case that the licensed software is invalid, remedies usually agreed upon are that a licensor will provide a license from a third party at no cost, or that a licensor will provide substitute software free of any such infringement claims that occurred related to the original software, and finally, a licensor can return the license fees. Lastly, when it comes to backup copies of the software, unlike the purchase of the copyrighted computer program, the licensee is usually not allowed to make such copies unless it is agreed upon in the license.

5 Know-how license

As explained above, know-how can be defined to include tangible materials as recipes, formulae, designs, drawings, patterns, blueprints, technical records, specifications, lists of materials, technical products and process manuals, written instructions for operating the process and analytical means for checking and controlling the product and process. It can also include intangible information consisting of practical procedures, details of workshop practice, technical training or personal visitation and inspection. It may additionally include information relating to the patented invention not included in a patent specification, inventions capable of being patented but not patented (yet), inventions incapable of being patented in a certain country because the patent law of the country excludes that subject matter, inventions incapable of being patented because of lack of inventive height, industrial designs not patented because of the reasons mentioned above, skills, experience and craftsmanship of the technicians.[18]

The difficulty with licensing know-how stems in large from the delicacy and the brittleness of its existence, since it is the secrecy and not the underlying of information that creates its values. With the loss of that secrecy, the value is lost as well. The implications it has on the license, and even more on the licensor is that the licensee will not cease to use the property, he just won‘t be obliged to pay for that usage any longer. Just as explained above, unlike the patent license, where the licensed

[17] See Poltorak and Lerner supra note 3. at 93

[18] Hale A. Newcomer, Legal Protection and Licensing of 'Know-How' Internationally, 1970, American Business Law Journal, Vol. 7 Issue 3, at 228

property is closely defined, know-how usually takes the form of a large collection of related materials. It is up for the licensee to see that it got sufficient disclosure and assistance to enable it to utilize the licensed property properly and effectively. It may wish to require the disclosure and level of assistance which will enable him to effectively utilize the licensed know-how. Such definition will usually contain an open-ended commitment on the part of the licensor and a warranty that a licensee will be able to effectively utilize the licensed property.[19] When negotiating the level of help and assistance, the licensor may wish to limit the amount he will provide, or to require certain payment for assistance beyond a specified level.

While patents only have the effect in the issuing country, know-how is worldwide effective, which makes the potential scope (geographic) of the license worldwide. Another crucial difference between patents and know-hows is that the patents have a limited term, while know-how is potentially unlimited, which makes the term of such licenses also potentially unlimited (the term can also be defined as a fixed period as well). The importance of termination provisions needs not to be emphasized. What happens if the licensed property becomes publicly available? As seen above, the licensee will not be obliged to pay the royalty fee, and will be free to use the know-how which has ceased to be valid (since „the genie is out of the bottle", the know-how is obsolete). That is why, the termination clause providing for the termination of the license in such cases has the effect of licensee not being obliged to pay for something that has just become freely available to everyone else, and should by all means insist on having this provision in his agreement. In case the licensee does a rather sloppy job of not insisting on it, it will have to pay for such information until the license expires.

Without a doubt, the most valuable part of know-how is maintenance of secrecy, which makes the provisions headed towards the preservation of confidentiality the crucial part of the license. It makes sense that the least licensee can do, is treat the licensed property as *bonus pater familias.* In an ideal world, the know-how information should be limited to those who „need to know", and all such individuals should execute the agreement acknowledging the confidential nature of the information. It would be best if the parties to the agreement would acknowledge that the confidential information is critical, and that any disclosure (unauthorized or unintended) would cause irreparable harm, that the loss engendered by such disclosure could not be adequately compensable in money, and that the parties thereof stipulate to the prompt entry of preliminary and permanent injunctions barring such disclosure, in addition to such other remedies as may be appropriate.[20] Another very important aspect of licensing know-how is concerned with the licensee as an individual. After a licensor has agreed to license his secret know-how to a certain licensee, usually after he is certain that the licensee is fit to keep the secret, it would be quite dangerous if that licensee could sub-license the know-how to a third party, of which the licensor knows nothing of (and which might even be the closest competitor of the licensor in the worst case scenario). In order to avoid such scenarios,

[19] See Poltorak and Lerner supra note 3. at 70

[20] See Poltorak and Lerner supra note 3. at 73

it is advised to include a provision in the license, which forbids the licensee any assignment of the know-how. The least a licensor should agree to is that any assignment of the licensed know-how is conditional on his written approval.

Termination of a license in the event that the secret information becomes publicly known has already been discussed, but another issue closely related to it still needs to be mentioned. If the information is publicly known, and the know-how is usually a compilation of knowledge already known to the public, the licensee already acquainted with the information may attempt to reconstruct it from publicly known and available sources. Every licensee would have the incentive to do so, and since already familiarized with the information, he would certainly have higher chances of success. In order to prevent such events, the usual thing to do, is to define the „publicly known" term in the licensing agreement as „from a single source". This basically means that unless the licensed property is found in one single source, it is not publicly known.

As in any other licensing agreements, the licensee may demand warranties that the licensed property will not infringe third parties rights, which in the case of know-how seems to be a bit harsh, and that is why the usual thing to do is to seek warranty that the licensor has the right and authority to grant the license, and that the grant will not constitute a violation of any agreement between the licensor and a third party. Of course, just as in the case of patent licenses, where the licensees may wish to include all the improvements made subsequently, such demands are also usually made by the licensees of know-how.

6 Royalties

After discussing the types of IP licenses and what is specific for every individual kind of license, the question that is usually considered first, and in almost every case longest, are royalties and royalty rates. Not only are the parties agreeing on how much money should be paid to the licensor for licensing his IPRs, but in which form should he receive this compensation is also a hot issue.

6.1 Paid-up license

Paid-up license is a kind of license where the royalty is a fixed sum of money. Depending on what is agreed, it can be paid over a period of time (usually the schedule of payments has been agreed) or can be paid as a lump sum. Peculiarity of this type of royalty payment is that, once it is agreed, it is not dependant on the success of the license. Sales made by the licensee can go sky high or can be practically nil, but still the royalty is a fixed sum agreed upon by the parties. Since this kind of payment method is a two-edged sword, both for the licensor and the licensee, it is most commonly used in situations where future sales are relatively easily predictable. And because it gets harder to predict future sales the longer the forecast period is, paid-up licenses are being used where the license term is short (or where the licensed property will expire shortly). Paid-up licenses are preferred not only by larger companies which try to avoid the difficulties with accounting the sales of

licensed products (which is a trait of running royalty licenses) but also by small licensors which often have only one patent (or any other kind of IPR). In a case where such IPR is for one reason or another found invalid or unenforceable, the licensor is left without income if the running royalty license is agreed upon. Generally, paid-up license in situations like this, once paid is nonrefundable (unless explicitly agreed differently).

6.2 Running royalty license

Running royalty license is, unlike the paid-up license, based on actual sales. If a licensee needs to pay for the license a percentage from actual sales of licensed product(s), than the need to forecast the sales, or the success of the license is out of the equation. This kind of royalty payment is preferred by the licensee with cash flow problems, and most likely it will be used where the license concerns the production and sales of consumer products (not industrial), since most of the economists agree that this allows the licensees to transfer part of the cost for the license to the consumers (by raising end price of the final product).

Basically, the royalty rate is determined in a way that it reflects the benefits the licensee enjoys because of the license. Usually, the royalty is set within the range of ¼ to ½ of the expected benefit or net profit of the license. For instance, in situations where the licensee expects a net profit of 8% of the sales price, the royalty rate would be 2% (8% x 0.25). There is a number of factors which are taken into consideration when negotiating the royalty rate. Typically in a process of haggling, the licensor will point out the costs required to create the licensed IPR, and on the other hand, a licensee will point out the costs needed for investments made in order to make any profit. A higher royalty could be justified in situations where the use of licensed IPR will most likely boost the sales of other products (or services) of the licensee. Of course, the significance of licensed property as the component of the product (or service) it is incorporated in is also an important factor. The position of the property in the product market is one of the determining factors of royalty rate. If the product incorporating the licensed property has no close substitutes or the substitutes are rather costly, than the royalty rate can be high. The very strength of IPR must be included into equation when discussing the royalty rate.

> They are usually higher for patents and trademarks, than for know-hows, primarily because it is easier to enforce these rights, and another important element related to IPR is how easily can these rights be circumvented.

When situations occur, in which it is possible to compare royalty rates for a certain property between independent licensees, than there might be an „industrial standard royalty rate“. One, or both of the parties may seek the royalty rate (higher or lower, depending on the party in question) by comparing the rate to the previously granted licenses. The degree of exclusivity of rights granted also has a

bearing on the designation of the royalty rates. An exclusive license clearly has a higher royalty level, than a sole or non-exclusive one. The difference in value will depend also on the market sector concerned, as well as the relative strengths of other licensees.[21]

As it can be seen from the factors relevant in determination of a royalty rate, the most basic principle entrenched in the core of royalty rate determination is risk and price balancing. Every licensee will seek to minimize the risk of projects that they are investing into (but if the reward will be substantial, most of the investors are willing to take bigger risks), so they will seek out the license for a more certain property. The greater the perceived risk associated with a new technology, greater the reluctance to invest substantial resources to acquire and commercialize it, and as a result, the lower the price the technology will be able to command. Once the relationship between the price and the risk is recognized, the solution becomes obvious: reduce the risk associated with a technology, and the price it commands will increase.[22]

Most of the experts in the area of licensing agreements and negotiations related thereto agree that the best strategy a licensor can do, is to offer not only IPR, but whenever possible a proven product (or service) related thereto. The licensee will be willing to pay more for a packet-ready technology. Another thing that is gladly suggested is to license not only a single IPR but a sort of a package deal, wherever possible, so that for example, the license includes not only a patent, but also applicable trademark, blueprints, market research data, list of qualified suppliers and everything else that could help commercializing the patented technology. This information is important for the buyer, since it reduces the risk of failure, which as stated before, keeps the position of the licensor in royalty rate negotiations high.

7 Enforcement and supervision of a license

A rather common miscomprehension is that once the license is executed, no more work needs to be done. However, after it is executed, the license needs to be supervised, firstly in the aspect of royalties: is the licensee paying the royalties on time prescribed under the agreement? Basically, this question simplifies the situation since it contains three different issues. Primarily, has the licensee made the payments on time, as prescribed in the agreement? Then, were all the payments made by the licensee received by the licensor? And finally, are all the sales being reported?

One might be surprised that quite often „it slips from the licensee‘s mind“ to make the scheduled payment. It is up for the licensor to remind the licensee in writing that the payment is overdue, and in order to do so, the licensee needs to actually know when the license payment is due. Not

[21] http://www.medius-associates.com/public_downloads/articles/Royalty_Rates_Current_Issues_and_Trends.pdf, last visited August 21, 2011

[22] Poltorak and Lerner supra note 3. at 107

surprisingly, licensees sometimes fail to report all of their sales, so the first step the licensors make is comparing the payment with the previous payments made, or the payments from other licensees. If the licensor, during the contemplation of the license finds certain anomalies, or finds any reason to be suspicious, than possibly the licensee has failed to report all of its sales. It is easier to monitor a licensee which is a public company, since the company law of many countries allows at least some kind of information to be disclosed to a licensor regarding the communication between the licensee and its shareholders (through which the licensor can find more information about the sales). Also other sources can be indicative, such as licensees' web site (it is hard to claim that the business is not doing good if the web site shows that the licensee is expanding its business), press releases, annual reports and so on.

Another common thing a number of licensees do is not reporting sales of new products or new models of old products (this occurs usually after a certain period of time elapses since the license agreement is made). This is why the web site of the licensee is always a good starting point for the licensor to monitor the product catalogue of the licensee, in case some new products „magically" appear. Most license agreements usually include a provision which allows a licensor to audit books of a licensee (only to extent of verifying the accuracy of information the licensee is providing). Since audits are expensive, they are not taken so easily, but often a threat of an audit is enough to achieve the desired result.

Finally, the licensor should (in case a territory has been allocated to the licensee) monitor if the licensee is selling outside the designated geographic area (a question that raises many competition law concerns). If the license includes limitations on the product (power, capacity, size) the licensor should make sure that none of the products sold fall in the proscribed areas.

8 Conclusion

As it can be seen from this paper, intellectual property rights are crucial for free market economy, which relies heavily on innovation. Without encouraging the innovation by giving the award for an innovator in the form of legal monopoly, there would simply be no progress made, and the Commission is placing special emphasis on dynamic efficiency when enforcing its competition policy. Since not every inventor is able to materialize the invention, and IPRs are transferable and marketable as well, the most common thing to do is to license them to someone that is able to fully exploit them. Not only does the inventor use IPRs to directly create income, but it is also common to cross-license another holder of similar rights, or even grant a license in order to penetrate and test unexplored markets.

The article discussed core technologies that can be licensed: patents, know-how and software copyright, with strongest emphasis on peculiarities of patent licensing agreements, since it is the most frequently used type of IPR that can invoke competition policy concerns, but still know-how and software licensing are dealt with in detail. After covering specific types of agreements, general overview of royalties and license enforcement is given, the reader is (hopefully) given a full picture on how licensing works in real life. Even though the deadline for adopting new TTBER is April 30th

2014 and some changes are expected to be made, this article will remain compatible with the next Technology Transfer toolbox, and serve as a effective and practical introduction in order to better understand the interaction between IPRs and competition rules.