



# Preserving the value of licensed intellectual property

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## **Preserving the value of licensed intellectual property**

### **Introduction**

A person who owns intellectual property can benefit from it in one of three ways (i) use, (ii) sale, or (iii) license. A licence is a means of extracting value from an IP right in areas where the IP owner does not wish to (or cannot) trade. For example, different business sectors or locations. It can be a very effective means of maximising value for the IP owner and means that the licensee is saved the time and expense of developing the IP right in the first place.

When licensing intellectual property, the licensor will have two key considerations in mind:

1. obtaining an acceptable rate of return, e.g. via an appropriate royalty; and
2. ensuring that the intellectual property is returned undamaged when the licence agreement comes to an end e.g. no damage to a brand's reputation.

Because the rights which are given to a licensee (i.e. the person who licenses the IP right) on a temporary basis, they will return to the licensor (i.e. the person who owns the IP right) once the licence ends. If the usage of the intellectual property was not carefully regulated during the term of the licence, on termination the value of the intellectual property may be damaged, possibly beyond repair. In the worst case scenario, the licensee's usage of the intellectual property could compromise its validity (e.g. because a trade mark has not been used and is vulnerable to an attack for non-use).

This guide looks at the ways in which the integrity of licensed intellectual property can be protected and focuses in particular on protecting licensed trade marks.

### **Contracts as a shield**

In common law jurisdictions, statute provides little comfort for a licensor that the intellectual property will be returned intact.

The same is true of the common law itself. For example, there is no fiduciary duty owed by a licensee to the licensor. Therefore the main way in which a licensor will protect the intellectual property is through the terms of the contract. Although there are no standard contractual clauses which will fully protect the integrity of all types of intellectual property, there are several categories of clauses which can be adapted to protect most kinds of intellectual property and which are commonly found in such licences.

These clauses can be broken down into four broad issues:

1. use of the intellectual property;
2. quality of the licensee's output;
3. infringement or challenge to the IP right by third parties; and
4. consequences of termination and post-termination.

### **Pre-Contractual Considerations**

The best way to preserve the integrity of the intellectual property is for a licensor to choose a good licensee. A bad choice of business partner may mean that despite having a legally strong contract, the intellectual property may be returned damaged or worthless. Moreover the contractual remedy of damages (i.e. financial compensation for loss) may simply allow the licensor to become one unsecured creditor amongst many.

Intellectual property licence arrangements will often require a significant degree of co-operation between the parties throughout the term of their relationship, not least in their efforts to protect the intellectual property. It is therefore important for a licensor to have trust and confidence in the licensee.

In essence a prospective licensor needs to consider carefully the suitability of any prospective licensee, analysing the attributes which will make the licensing arrangement a success. Depending

on the product or service in question, a licensor will often want to see evidence of a strong financial position and a proven track record in the manufacture, promotion, distribution and sale of comparable goods.

### **Usage of intellectual property**

Intellectual property licences should contain usage and quality control provisions which will protect the licensor's interests, irrespective of the particular type of underlying intellectual property. For example, a trade mark licensee must be prevented from using the mark in any manner which could mislead the public with regard to the origin of the goods or lead to the mark becoming generic. The representation of such a mark must be completely accurate at all times and carried out in accordance with the detailed instructions of the licensor.

In order to police these provisions, it is advisable to include rights to inspect premises and to examine samples of the goods, possibly at the licensee's expense. These provisions will have to cover all aspects of the goods (such as their packaging and promotion). In addition, the licensor will wish to reserve the right to terminate the licence in cases of material breach.

Examples of some clauses which deal with these issues, in relation to trade marks, are:

*1.1 All Licensed Goods manufactured and sold by the Licensee during the continuance of this Agreement must bear the Trade Mark. The Licensee shall apply the Trade Mark to the Licensed Goods only in the form and manner specified in writing by the Licensor from time to time.*

*1.2 The Licensee shall ensure that wherever the Trade Mark is used it is followed by the ® symbol, or the words "Registered Trade Mark of [the Licensor]".*

*1.3 The Licensee shall ensure that no other marks, symbols or wording shall appear on the Licensed Goods without the prior written approval of the Licensor.*

Clauses 1.1 and 1.2 offer basic protection for a licensor that the goods will bear the licensed trade mark as the Licensor has directed and that the trade mark is identified as being registered or belonging to the Licensor.

Clause 1.3, which prohibits the mixing of intellectual properties, is less obvious, but perhaps just as vital. The mixing of intellectual properties readily occurs, for example, where a licensee includes a trade mark as part of its company name. This particular situation, although covered by clause 1.3, is expressly dealt with in clause 1.4 below to avoid any confusion.

The risk to the licensor is that the terminated licensee could claim a continuing right in the trade mark by virtue of having it as a part of its company name. However, provisions such as these, which limit the mixing of intellectual property, must be balanced against commercial realities: such a clause would be of limited application in fields where intellectual property has been specifically licensed for integration into a complex product and where the intellectual property has no independent value.

*1.4 Notwithstanding the foregoing, the Licensee shall be permitted to use its trade name on packaging materials, and in advertising on promotional materials.*

*1.5 The Licensee shall use the Trade Mark on labelling and packaging in accordance with the provisions of this Agreement. The Licensee shall comply fully with any additional requirements under the applicable local law with respect to the labelling and packaging of the Licensed Goods.*

Clauses 1.4 and 1.5 serve a useful commercial purpose for both licensor and licensee, by encouraging the use of a trade mark on packaging and promotional materials. But these clauses also help to protect the integrity of the trade mark, by expressly making it a term of the contract that the licensee must comply with local laws relating to the labelling and packaging of the goods. A famous licensed brand would surely be harmed if it was packaged in defective packaging. By placing

compliance with local standards at the heart of a trade mark licence, a licensor has the possibility of ending a contract with a noncompliant licensee.

The licensor may also want to reserve rights of approval over advertising and marketing materials produced by or on behalf of the licensee, as not only will this assist in maximising the return on the licence, it will ensure that such promotions fit in with the Licensor's strategic plan for its property.

## **Quality**

Ensuring that the licensee is making proper use of the licensed intellectual property is often vital for the maintenance of its integrity. This is especially since the commercial value of a trade mark could quickly vanish due to misuse. The following clauses are an example of the kind of wording which may be used to control the quality of products manufactured using intellectual property:

*2.1 The Licensor shall advise the Licensee in writing of the standards and specifications from time to time of the Licensed Goods.*

*2.2 Upon request by the Licensor the Licensee shall at its own expense furnish the Licensor with randomly selected samples and packaging of the Licensed Goods. The Licensor at its expense shall also have access to the Licensee's premises during normal business hours in order to inspect such samples, and the methods of manufacture, storage and distribution, and to remove a reasonable number of samples at no charge for further examination.*

*2.3 The Licensor may reject any such samples by furnishing the Licensee with a written notice of rejection no later than 20 Business Days after removal of the samples. If such written notice of rejection is furnished, the Licensee may not distribute the Licensed Goods until the Licensee has taken all necessary steps to meet the Licensor's objections (in the opinion of the Licensor), and the Licensor furnishes the Licensee with written authorisation. If the Licensor does not furnish written notice of rejection within 20 Business Days as aforesaid, the samples shall be deemed to be approved by the Licensor.*

Clauses 2.2 and 2.3 represent one way in which a licensor may implement a quality control programme. Indeed, a licensor may wish to have a far more active role in the production process than merely inspecting random samples. This is particularly the case if the licensor feels that there is some risk that it may become liable, should a sub-standard product be manufactured by its licensee. However, there may be commercial difficulties in obtaining the licensee's agreement to intrusive oversight. A potential licensee may prove unwilling to permit the licensor to inspect its premises, as envisaged under clause 2.2, or to suffer the expense of providing random samples in a low volume, high-value industry. Perhaps the only certainty is that, given the virtually limitless range of products and processes which can be the subject of intellectual property licences, the licensor will need to give a great deal of thought into the framing of suitable quality control provisions.

*2.4 The obligations of the Licensee shall apply mutatis mutandis to any sub-contractor.*

This bit of Latin basically means that a licensor wants to impose similar conditions on sub-contractors as on the licensee.

In addition to a provision such as clause 2.4, an intellectual property licence should also clearly set out what rights the parties have to assign or sub-license their interests. It is common for the licensor to specify that no assignment or sub-licensing is to be permitted by the licensee. This is because of the danger that the intellectual property could be damaged by the activities of an assignee. This is particularly so in respect of a sub-licensee over whom the licensor would have no contractual control. Given that it is so important to choose a licensee which meets the licensor's standards, unregulated assignment or sublicensing could introduce an unwanted partner into the relationship. One compromise would be to allow the appointment of sub-licensees in respect of whom the licensor has given its prior written approval.

## **Third Party Infringement**

Infringing use of intellectual property by a third party harms the IP's integrity. Both licensor and licensee will want to ensure that such infringement is dealt with, but the distribution of responsibility (and the associated costs) should be agreed in advance in the licensing contract.

Third party infringement is one of the rare areas in which statute can assist. For example, under English law, a registered exclusive licensee of a trade mark can sue for infringement in the place of the registered proprietor. A nonexclusive licensee, by contrast, may only bring infringement proceedings if the registered proprietor fails to take action within two months of a request to do so by the licensee.

These rules are subject to agreement to the contrary. As such, the issue of the parties' rights in respect of third party infringements should still be dealt with in an intellectual property licence. Licensees may wish to be granted substantial rights in addition to the above statutory rights – for example, to call on the registered proprietor to co-operate fully (possibly at his own expense) in infringement proceedings brought by the licensee against the third party.

However, it is common for a licensor to refuse to grant his licensee any rights in respect of third party infringements, including the statutory rights which would otherwise apply, because there is a risk that the licensor will give up control of infringement proceedings. A licensor may wish to retain control of infringement proceedings in order to see that they are vigorously pursued, particularly if a defendant chooses to challenge the validity of the licensed intellectual property. A licensor may well have different priorities to that of a licensee when negotiating any settlement.

Clauses dealing with third party infringement will need to be extensive and cover both the situation by which the intellectual property is being infringed ('offensive' clauses) as well as where a third party is challenging the validity of the intellectual property or alleging that the licensor's intellectual property infringes the rights of a third party ('defensive' clauses).

'Offensive' clauses may go beyond merely obliging a licensee to passively respond to third party infringement and could require the licensee to actively investigate these acts. Such a clause might read as follows:

*3.1 The Licensee shall use its reasonable endeavours to identify any potential infringement, actual or suspected, or any other unauthorised use of the Intellectual Property by another person within the Territory and shall promptly notify the Licensor of any such infringement.*

Similarly, the licence agreement should impose a duty on the licensee to actively ensure that the licensor is kept fully informed of suspected infringement.

### **Consequences of Termination / Post-Termination**

Upon termination, there is a risk that the intellectual property will be diluted by a terminated licensee. For example, the former licensee may have strong commercial reasons to continue exploiting the intellectual property, even without a licence. This may particularly be the case if the termination was acrimonious. Even if the termination occurred by agreement of the parties, it may make sense for there to be a transitional period, where a licensee may make limited use of the licensed mark, such as through sale of its inventory. Such a 'winding-down' clause could, for example, specify the channels by which any remaining inventory can be sold and limit the period of time over which these sales may take place. For example, an upmarket fashion brand may object to a terminated licensee from selling its inventory to downmarket retailers.

### **Conclusion**

As this guide illustrates, there are many important considerations which must be borne in mind when drafting intellectual property licences if each party is to receive suitable protection and to foster an appropriate return on investment. Reaching an appropriate balance between the parties at the outset can prove crucial should a licence arrangement turn out to be less than ideal.