

It's Okay if What's Mine is Yours:
The Potential Benefits of Licensing



By: *Matthew T. Soble / June 23, 2009*

All too often negotiations are stalled and even ended because both parties are adamant about owning whatever it is they're paying for or whatever it is they've created, and convinced that ownership is the only way to accomplish their goals.

Although choosing between licensing and buying or selling is a decision that must be made on a case by case basis, and it may indeed be worth holding fast to the desire to own, choosing not to own may actually be in the best interests of the client.

Using intellectual property, and specifically software, as an example of one of the "things" clients often want to own, the following article provides an overview of key issues and provides at least *some* insight into the potentially advantageous possibility of choosing licensing over ownership.

Key Considerations

Consider this scenario: Our client wants to hire a software developer to take an existing piece of general business management software (previously created and owned by the developer) and modify it for a specific industry or purpose. Essentially, the developer is going to take its existing software ("A"), create and add new components ("B") and ultimately end up with, and provide to our client, new,

customized software ("C"). Therefore, and remembering my grade school math, "C" = "A" + "B"

Prevention– If the client's goal is to end up with software that is different or better than software used by other (similar) companies and thereby to gain a competitive advantage, ownership of "C" (the final product) may be unnecessary. A license granting the client the exclusive right to sell and/or sublicense "B" and "C" would provide the same protection – The developer wouldn't be able sell or license "B" or "C" to anyone else. However, such a license wouldn't restrict the developer's use or ability to modify "C" or "B" to develop customized software for other, non-competing companies and industries (which, although seemingly a negative, may have its benefits as well).

Freedom – If the client's goal is to have the freedom to modify, resell and/or license "C" to others, ownership of "C" and all work product ("B") may seem like the obvious and best approach. But remember, "C" = "A" + "B", and without the rights to sell and sublicense "A", the client wouldn't be permitted to sell or sublicense "C" (and possibly not be able to modify "C" if it involved changing "A" in any way) without risking being on the defensive end of a claim for infringement of the developer's intellectual property rights. Anyone who purchases "C" from the client could also find itself facing a

claim for intellectual property infringement, and the client might find itself liable to both the software developer and the company to which it sold "C". Again, a license to the client granting it the rights to modify, sell and sub-license "C" would provide all the rights the client is looking for in this scenario.

Reducing Costs – At the end of the day, a license from the developer covering "A", "B" and "C" (rather than a purchase) may result in a lower cost for the client, as the development of "B" and "C" wouldn't be a one-time project for the developer and would leave the door open to other possible projects using the same base software.

If the client is adamant about ownership of "C" and "B", in addition to securing a license for "A" (which, as I indicated, could be critical), one may want to license "B" and "C" back to the developer for limited purposes. Such a license may reduce the overall costs, as license fees could be set off against the purchase price. *(I know that so far I've taken the purchaser's/licensee's side, but as a note for software developers – selling "C" and granting a non-exclusive license to "A" and "B" would be a good option, as it may give the purchaser the comfort and satisfaction of "ownership" while keeping the developer's rights intact vis-à-vis "A" and "B", and letting the purchaser own the final product may result in a higher price.)*

Creating an Ongoing Relationship – Licenses involving royalties and/or support obligations keep relationships between parties alive, and allow for the monitoring of the other party. After a sale, typically, there is no such interaction and creating ongoing obligations might be beneficial to both the client and the software developer.

Ensuring Adequate Protection – When accompanied with robust indemnity, limitation of liability and non-competition/non-solicitation clauses, one or more licenses (from and to the developer) may be sufficient, and even preferred, to ensure the agreement meets the needs and wants of both the client and developer.

Preparing for the Future – Whether a purchase or a license, when drafting representations and warranties for future deals which include whatever might be licensed or owned, the client needs to be sure of exactly what rights it possesses. For example, if or when the client should decide to sell some assets and include "C" in the asset sale, or sell shares in the company which owns such assets, the client needs to know what he/she owns and what he/she has

licensed. Or, more to the point, the client needs to know whether the transfer or sale of "C" would infringe the rights of the developer. Remember, whether owned or licensed, "C" is always "A" + "B", and the rights the client has in regard to "C" are only as good as the sum of the rights the client has in "A" and "B." Because "C" is a derivative work of "A", further sale, transfer or copying of "C" may infringe the developer's rights in "A" (and maybe even "B"), regardless of whether the client owns "C".

A Note About Open Source – Be careful about "open source" software. Although 'free' and open to everyone to use and modify, open source software is still subject to license restrictions. Typically, the whole point of open source software and code is to foster further development by keeping each and every derivative work in the chain of development both available and free to all others. For example, if the developer uses open source software as its "A" components, you may find that the license to use and modify "A" requires that "B" and "C" become free and open source as well, thereby removing all power, control and competitive advantage.

A Note About Indemnity Provisions – If acting for the party hiring the developer, there needs to be a strong indemnity provision regarding any intellectual property infringement on the part of the developer. Sometimes developers (i) use code created by others without even knowing or realizing it, and/or (ii) use open source material, and the client may later find itself defending a claim for intellectual property infringement or breach of an open source license. Adequate protections and remedies need to be put in place in the event a court orders that the software be released into public (as open source software) or the client is forced to stop using the developed software. Of course, remember that an indemnity is only as strong as the wherewithal of the indemnifier.

Conclusion

Although each party and each situation must be carefully assessed on a case by case basis, hopefully the above has shown, at least to some extent, that you can get what you need and what you want while letting what's "yours", be "theirs".

Key Components of Licensing Agreement:

1. **The Grant** (i.e. the scope of the license(s)): What can each of the licensee, and the licensor, do with what is being licensed and/or purchased?

2. **Representations and Warranties of the Licensor:** What is the licensor representing and warranting? (e.g. that the licensor has the rights it is licensing)
3. **Indemnity by the Licensor:** How will the licensor compensate the licensee in the face of a claim for intellectual property infringement, breach of contract by a third party, etc.? What is the licensor's financial strength?
4. **Limitation of Liability:** What is the maximum liability of the each party?
5. **Term and termination:** How long does the license last, who can terminate, and where does that leave the parties post-termination?

6. **Continuing Obligations:** For example, what are the support and repair obligations? What are the royalties, etc.?

~Matthew T. Soble

Matthew is an associate at Fogler, Rubinoff LLP and practices in both the Business Law Group and Litigation Group. His practice areas include Sports/Entertainment, Intellectual Property and Technology Law. He can be reached at 416.864.9700 or msoble@foglers.com.

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