Licensing in Data Processing Industry

How licensing has developed in a major growth industry in the last ten to 15 years

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Consider that Company A is a manufacturer of main frames (central processing units) in the United States. It markets those items through its own sales force, to both OEM's and end users in the United States and to end users in Europe. It plans to market the product in Japan.

At present, Company A procures semiconductor circuitry from a major semiconductor "house". It plans to start its own semiconductor venture in the future; first, as a captive supplier and then as a supplier to others.

Company A also plans to expand its product line to include peripheral devices. These would be obtained initially from others and then manufactured in-house. Its ultimate goal, which has been delegated to you for accomplishment, is to have a licensing program that will give freedom to make and sell products and give its customers freedom to use those products. How would you go about achieving this?

First, a few comments about the nature of Company A. Assume that, being a new company, it has what might be called a marginal patent position; in other words, it probably has a number of patents on file, both in the United States and abroad, but very few, if any, issued patents. Further, assume that Company A is a well financed and managed company. Thus, it will respect the intellectual property rights of others and will not take the attitude of "don't do anything: let's wait until they sue us".

A first priority for Company A is to build upon its existing patent portfolio. It should adopt a selective filing approach wherein applications for patents in the United States are directed to those inventions reflecting concepts that appear in its own products or those inventions having the possibility of receiving patent coverage that will be of significant value in licensing discussions. At the same time, Company A should consider its foreign filing patent practices and — due to the increased costs of filing abroad as well as maintaining a patent portfolio abroad — should file applications on those inventions in countries where it expects to manufacture product or in countries where the patent laws favor national organizations. As a general rule, Company A's filing practices outside the United States should be measured by the same yardstick used to measure its degree of business (both manufacturing and marketing) activity in that area.

Company A's basic approach to patents should, in all probability, be one of seeking freedom of action so as to be able to implement its business plans with a minimum of concern about the patents of others. Since most of its activity initially will be in the United States, Company A will no doubt seek licenses from the major main frame manufacturers there. In negotiating such licenses, Company A may well want to enter into a cross license wherein existing patent portfolios, foreseeable patent potential, and foreseeable business activity are factored into an equation resulting in a quid pro quo. On the basis of the fact situation above, Company A should probably be prepared to make a balancing payment to these potential licensees. Company A's choice, relative to licensed patents, in a cross license could be that of taking a license under certain named patents or taking a license under all patents to make defined apparatus. The former approach offers the advantage of minimizing the consideration to be exchanged while the latter approach offers the advantage of maximum freedom of action under the patents of others.

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Rather than a cross license, of course, Company A may choose to seek a license on a running royalty basis from the main frame manufacturers. In that instance, it may well find a variety of royalty rates, but in general, will find those rates to average lower than rates in other industries. Note that the fact situation talks of Company A selling to both end users and on an OEM basis. Licensors may want to obtain the same dollar amount for the use of their inventions regardless of how the ultimate product is disposed. Thus, Company A may find that a running royalty rate for apparatus sold on an OEM basis will be higher than the rate apparatus sold to an end user; one reason for this difference being that the sale price to an end user is higher normally than that to an OEM.

Note that the fact situation talks about Company A's desire to market its product in Japan. While negotiating with the main frame manufacturers in the United States, it would be wise to seek an option to rights under patents they may have in Japan. Company A may need such rights at some time in the future. While negotiating for those rights, Company A should also bear in mind just how it will structure itself in order to do business in Japan; for example, will it form a subsidiary with a Japanese partner, or will it choose to market through representatives in Japan, etc. Company A must also recognize the necessity of interfacing with the Japanese

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Government when doing business in Japan. These considerations are not a direct factor in licensing relationships with the main frame manufacturers in the United States, but Company A may well consider—if asked to provide rights to subsidiaries of those U.S. companies now in Japan — conditioning the rights to such subsidiaries upon the ability of Company A to operate in Japan.

One of the factors that, to some extent, is unique about the computer industry is the concern of computer manufacturers and suppliers to provide their customers not only with apparatus to perform a function, but freedom to use that apparatus in a maximally uninhibited fashion. Thus, Company A may well want to seek rights from its licensees for Company A's customers of main frames to combine those main frames with other apparatus, like peripherals. One approach to this would be to seek an immunity from suit under the patents of their licensees directed to such combinations. The immunity would be granted directly from the licensee to the customer and — since there is a body of law that differentiates an immunity from a license — the licensees may be more inclined to grant an immunity (as opposed to a license) without fearing an adverse impact on their licensing relationships with others.

Along the same lines, Company A must recognize that their main frames will operate under the control of programs and it is probable that program patents, as they issue, will also present concerns to Company A and their customers. Since the art of programming, from an inventive viewpoint, is in an early stage and licensing practices are not well established — at least in the patent area (as opposed to the copyright area) — Company A may also seek an immunity under the program patents of its licensees for Company A's customers. This immunity, for bargaining purposes, could be structured so as to extend to the main frame only while in the possession of the first customer. An immunity, by nature being personal, is held by some not to run with the goods and, again, Company A's licensees may be willing to enter into this type of an approach without fearing an adverse impact on any plans to license program patents to others.

With reference to the subsidiary question, it is common in licensing within the computer industry (as in other industries) to allow a licensee to pass on rights to its subsidiaries, particularly when those subsidiaries are majority-owned by the licensee. Should the licensee have less than a majority interest in, or otherwise lack control of, the subsidiary, arrangements can still be made for the licensee to extend rights to such a subsidiary so long as he is willing either to obtain rights back for the licensor from the subsidiary or idemnify the licensor against the future assertion of a subsidiary's patent, by anyone, against the licensor.

The fact situation goes on to talk about Company A's activity in the semiconductor business, and notes that it is planning to manufacture semiconductors in the future. While obtaining semiconductors from major manufacturers of those devices, Company A can rely on the normal indemnification that exists in purchase orders. However, since some main frame manufacturers also manufacture and develop semiconductors, Company A may consider, at this early point in time, either buying technology from those manufacturers or obtaining an option to buy such technology in the future. Doing this earlier rather than later, becomes more and more a practical business rule due to the inflationary situation that exists on a worldwide basis.

Company A also may well, at a later time, when manufacturing semiconductors for its own use, seek rights from semiconductor manufacturers to make and use semiconductors, but expressly yield the right to sell. Company A needs only rights to make and use, so there is logic which supports the position of not obtaining more rights than one needs — so as to keep the cost of rights down. The limitation on sale may be set forth in words describing an "over-the-counter" type of sale transaction.

In any licensing transactions with semiconductor manufacturers, the question of patent claims covering system functions should be addressed. That is, it is somewhat common for semiconductor patents to issue with claims directed to both a device structure and a system function (like half-adding, shifting, summing, etc.). Company A should try to obtain express rights to the inventions covered by such claims, but should also be prepared to expect that the consideration for such rights will be higher than if such rights were not granted.

The fact situation also discusses Company A's intention to expand its product line to include peripheral devices; for example, magnetic tape transports, rotating magnetic disk drives, and control units for each. In general, much of what was said previously about Company A's activities in the semiconductor field apply to their activities in the peripheral field. However, there are a few particular points that need discussing.

First, it should be recognized that control units for peripheral devices, when constructed by today's technology, frequently resemble — from a functional viewpoint — main frames or central processors. Thus, Company A may obtain many necessary rights in its initial transactions with the main frame manufacturers. Company A's choice of either a patent by patent license or a defined apparatus license was discussed earlier. The peripheral situation makes the defined apparatus license even more attractive than the patent by patent approach. In structuring the definition of licensed apparatus, Company A should be sure, initially, that the definition includes all apparatus having those functions characteristic of a central processing unit; in this fashion, controllers for peripheral devices may well be included within the initial license grant. However, Company A will have to deal with other licensors (and perhaps the same licensors) to obtain the rights necessary to make specific peripheral devices.

A second point relative to peripheral licensing is the question of whether a license to manufacture, etc. a central processor includes an implied license to combine that central processor with peripheral devices. The legal analysis of this theory becomes somewhat moot in actual licensing situations, because it is common practice to negate expressly any license, express or implied, that is not expressly conveyed. I simply want to raise this point for your consideration.