Optional Licensing Stipulations

How to handle licensing questions arising within framework of joint development, manufacturing programs

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In the majority of cases, cooperative ventures between two or more manufacturing companies take their origin in the fact that in its respective area of application, each firm alone may well command specific, patented or unpatented technical know-how in a partial field, but does not possess the know-how required to manufacture a viable product and to develop that know-how singlehandedly would cost too much.

These are reasons, then, why a company elects to enter into a cooperative venture.

A cooperative venture, however, may also result from a situation where a customer intends to entrust several manufacturing companies with the development and production of a certain product, as is frequently the case with government contracts awarded, specifically (in Germany), by the Federal Ministry of Research and Technology or the Ministry of Defense.

In either case each partner invariably provides a certain amount of his prior know-how into the cooperative venture for use in the joint development effort, and that know-how is inevitably disclosed to the other partner or partners in the venture.

Again, new know-how accrues during the life of the cooperative venture which the partners, by necessity or choice, will be using either jointly or separately.

Because the disclosure of know-how to some other partners carries with it the risk of its unwarranted exploitation by the receiving partners to the detriment of the disclosing partner, it is essential that questions conceivably arising in the course of cooperation be addressed in a cooperation agreement *before cooperation commences.*

COOPERATION AGREEMENT

In a cooperation agreement the partners should stipulate and precisely define the following essential items:

1. Object of cooperation.
2. Scope and breakdown of respective workshares.
3. Financial inputs of the various partners.
4. Partners' liability internal and external; i.e., the liability of the partners one relative to the other during cooperation, and the pro rate liability in the presence of customer or third-party claims.
5. Proprietary rights—rights of use.

Stipulation of title to partners' rights in know-how already existing before cooperation commences and the exploitation of these rights during cooperation, as well as exploitation of the rights arising during cooperation, form the core if not the crux of the cooperation agreement. Their impact on the cooperating partners is enormous.

Many a helpful cooperative project envisioned by prospective partners was never implemented, for the reason that the would-be partners could not agree on mutually beneficial stipulations regarding the exploitation of the prior know-how that the partners were to provide to the joint venture and of the accruing know-how that might develop in the course of cooperation.

STIPULATIONS REGARDING THE EXPLOITATION OF PRIOR KNOW-HOW THAT EXISTS BEFORE COOPERATION COMMENCES

Precise definition of the object of cooperation is crucial to the attendant stipulations regarding the transfer of technology, or to the protection afforded prior know-how and its exploitation by the partners in the cooperative venture.

Once agreement has been reached on the object of cooperation, each partner should best take stock of all patents and industrial rights granted and pending, wherever these relate to the object of invention, that he is holding *prior* to the cooperative effort, that must be used in the performance of cooperation, and that accordingly will be entered into it.

Another important consideration in this context is that the partners should agree on a certain date on which, in their estimation, cooperation should commence, considering that the exploitation of know-how accruing to the partners under the cooperative effort after that date will call for stipulations other than those covering the exploitation of the prior know-how they initially entered into the cooperation.

Fundamentally, at least under German law, the know-how developed and owned by a partner, remains his property when it is used by some other partner in a cooperation. The partner at most allows the other a right to use it free of charge or for a license fee. Even if this is an uncontested principle in law, it should nevertheless be adopted as a preamble into the contractual provision covering the rights of use.

The author recommends including the following wording in the agreement:

"Such patents, industrial rights applications, ideas,

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proposals, design schemes and manufacturing instructions, as well as manufacturing processes, as may have been provided to the cooperation, shall remain the unrestricted property of the partner who holds title to such patents, industrial rights applications, ideas, proposals, design schemes, manufacturing instructions and manufacturing processes and who entered them into the cooperative venture as of the date of execution of the agreement."

As previously indicated, the partners opted for cooperation in order to spread the financial risk and exchange know-how.

In order to develop and manufacture the object of cooperation, the partners accordingly need the respective know-how of the other partner also with respect to the workshare that the respective partner accepted as its own under the cooperative effort. Intent and purpose of the cooperative effort would be negated, however, if during the term of cooperation, the partners were to pay license fees to other partners for know-how used in the interest of cooperation.

For that reason, the following provision should be adopted into the cooperation agreement:

"*Each party to the agreement is entitled, without payment of a license fee, to use for purposes of cooperation, such patents, industrial rights applications and information as may have been contributed under item 1.*"

In the agreement the right of use is importantly restricted to the *purposes of cooperation* so as to prevent partners from using know-how for other purposes without paying a license fee.

STIPULATIONS REGARDING THE USE OF ACCRUING KNOW-HOW

In the course of cooperation, employees of the respective parties are likely to make inventions that relate to the object of cooperation.

Distinction should here be made between the following cases:

A. In its particular field of work assigned to it under the cooperative effort, either party makes inventions independently of employees of the other partner.

B. When endeavoring during the term of cooperation to coordinate the various fields of work one with the other in technical discussions, and when addressing problems relative to the object of invention, the partners' employees will conceivably make joint inventions that by necessity and choice they will be using for purposes of cooperation.

As explained above, the partners should be able to use jointly- or severally-made inventions in order to manufacture the common object of cooperation; and the purpose of cooperation, which is to achieve maximum economy of cost, would not be attained if the partners were allowed the use of such inventions and know-how only upon payment of a license fee.

On the other hand the partners should make sure that the know-how they reciprocally make available during cooperation by exchanging relevant documentation, will not be used for purposes other than the object of cooperation and that it will not be transferred, conceivably for a license fee, to third parties.

CASE A: Still going on the basic principle of each partner owning the know-how he developed, and considering the problems just described, the cases in which either partner makes inventions independently of the other partner during the term of cooperation, can approximately be covered as follows:

"Inventions made by company X during the term of this agreement in the performance of work under this agreement are the property of company X.

"Company X allows company Y for the term and purposes of this agreement, the *nontransferable* and free right of use in such inventions and any industrial rights and industrial rights applications resulting therefrom.

"Inventions made by company Y during the term of this agreement in the performance of work under this agreement are the property of company Y.

"Company Y allows company X for the term and purposes of this agreement, the nontransferable and free right of use in such inventions and any industrial rights and industrial rights applications resulting therefrom."

The wording "for purposes of this agreement" and "nontransferable" serve to prevent such inventions and industrial rights applications, as well as know-how, as may arise during cooperation, from being transferred to third parties *outside* the agreement.

CASE B: When employees of the respective partners make joint inventions, the basic principle of allowing the partners the free use of such inventions for purposes of cooperation, should remain intact.

This still leaves the question, however, of who is to seek protection for the invention and who is to defray the costs involved.

The author recommends the following wording to cover the problems just described:

"For inventions arising during the performance of cooperation, if they are due to inventive contributions from employees from both partners (joint invention), protection shall be sought under its sole name by that partner which contributed the predominant portion of the invention.

"If the partners are unable to agree on who contributed the predominant portion of the invention, and if breakdown of the invention into separately patentable parts is prevented, the right to seek protection under its name shall be allowed the partner whose area of activity (see ...... of this agreement) embraces the main object of this protective right.

"The partner seeking protection shall defray the costs involved in seeking and maintaining the protective right.

"The partners agree to charge a jointly appointed representative (patent attorney) with the pursuit of the application procedure and with the defense, enforcement against infringers and maintenance of the invention whenever a joint invention is involved."

In this connection, in agreements involving a German company, the provisions of the employee invention compensation law cannot be ignored.

Section 22 of the employee invention law mandates that existing regulations cannot be interpreted against the best interest of the employee. When the invention of a German employee is used, employee invention compensation is inevitable.

The amount of compensation for an invention depends on, among other factors: whether or not the invention is actually used: and whether the object of the invention is manufactured by the employer proper, or is made the subject of licenses granted by the employer.

If cooperative efforts involve German partners only, the problem of employee invention compensation can be covered as follows:

"Compensation for inventions, if payable in accordance with the law by one partner to his inventors shall generally be defrayed by whichever partner is commercially exploiting the invention involved. In the case of joint inventions the costs

shall be split to reflect the relative use the various partners are making of the invention.

Compensation for employee inventions is a special problem in international agreements, for the reason that foreign partners are not normally willing to subject themselves to the provisions of the German law on employee inventions.

The German partner, however, is invariably faced with an obligation to pay compensation for inventions used by the employer, and under a cooperative effort, when this invention is used, only the German partner will be charged with the costs of compensating for the invention.

It will be impossible to incorporate precise provisions into the cooperation agreement regarding the distribution among the partners of the costs of compensating for employee inventions, if such compensation must be paid by the German partner.

It should preferably be attempted, however, to providently incorporate into the cooperation agreement some wording to the effect that the other partner or partners *basically* agree to share in the costs should the German partner be charged with paying compensation for employee inventions, and that details be stipulated if and when that case actually arises.

STIPULATIONS REGARDING THE USE OF KNOW-HOW UPON TERMINATION OF COOPERATION

The circumstances under which cooperation is terminated may be any of those described below:

1. The partners agree to terminate cooperation.
2. One partner terminates cooperation, because he no longer takes an interest in cooperation or because he can no longer raise the funds required.
3. In a cooperative venture involving several (three or more) partners, one or more partners desire to expand the scope of cooperation because they intend to continue development of the object of cooperation and by necessity to utilize the know-how made available to them by other partners during cooperation.

Since during cooperation the partners will reciprocally exchange free of charge their severally owned, as well as their jointly developed know-how and since they will invest considerable funds in the cooperative effort, they should be all means consent — *before cooperation commences* — on how they intend to condition the use of know-how upon termination of the cooperative venture.

Cases 1 and 2

Regarding Cases 1 and 2, to start with, let us recall that the parties had consented to allow each other the reciprocal, *free*, nonexclusive and *nontransferable* right to use, for *purposes of cooperation*, the prior know-how they had severally entered into the cooperation and the accruing know-how that might arise during the term of cooperation.

Upon termination of cooperation, such consent cannot very well continue, for the reason that the parties involved were partners for the term of cooperation and that upon its termination, they may again become competitors that must protect their respective know-how.

Accordingly the following provisions should be made in the cooperation agreement:

"Upon termination of the agreement the parties hereto agree to license each other under reasonable conditions *transferable*, nonexclusive rights of use in the know-how made available to the partner or partners for purposes of cooperation in the field of cooperation, and in their severally or jointly owned, granted and/or pending protective rights and inventions. These rights of use, however, shall enable the recipient to use the rights within the field of cooperation."

At the time cooperation commences the various conditions cannot, as yet, be stipulated in detail, considering that it is still uncertain at what time into the future cooperation will be terminated and exactly what the compass of the severally or jointly-owned know-how of the partners will be at the time.

Nor is it possible, at the time cooperation commences, to predict what the market situation will be at the time it is terminated.

The ultimate phrase informs the parties from the start that the know-how to be shared shall not be used for competitive purposes in the field of cooperation.

Conceivably one or the other of the partners may desire to use the know-how and also other information for other purposes in a field outside that of cooperation, while the other partner may likewise envisage commercial potential in that field.

In that case the following stipulation will be appropriate:

"If one party to the agreement is desirous of using the patents and information made available to him by the other party during the term of cooperation, in an area of application other than that of cooperation, the other parties shall reach agreement in writing also as to the amount of license fee to be paid in that event."

Case 3

As for Case 3, cooperative ventures are in part formed also in cases where — in terms of company size and funds — a relatively large company joins forces with a relatively small company, for the reason that the minor partner possesses specific know-how that the other partner does not have but that he positively needs to develop an object. Upon completion of development and also of production of the object of cooperation, the financially stronger partner may then see a market for a derivative of the object developed. This may include, for example, variants on engine or even large and small aircraft types.

Then when the financially stronger partner desires to develop a variant, he is compelled to use the know-how made available to him by the other partner or partners during cooperation.

Development of a variant may involve tremendous costs that the minor partner may not wish or be able to invest.

The minor partner, again, should not equitably be in a position to veto the sale, by the major partner, of derivatives of the object of development that incorporate the minor partner's know-how.

How should these problems be addressed?

To start with, the other partner should be consulted and forwarded proposals as to the general circumstances and costs of developing the intended variant. He should simultaneously be invited to share in the development of this variant. Then when all partners agree to participate in the continued development, the stipulations of the cooperation agreement regarding the free use of the respective know-how shall apply, or the provisions of the cooperation agreement shall be extended to cover this case.

If, however, only or or more partners intend to pursue

continued development, he or they shall request the remaining partner or partners to indicate within a certain time, say four months, whether they intend to participate in continued development.

If within the time allowed therefore, the remaining partner or partners refuse to participate or fail to respond, the other partners shall have, in exchange for payment of an appropriate license fee, the nonexclusive and transferable right of use in the know-how made available to him during cooperation by the other partner who now refuses to participate in continuing development.

This stipulation involves a risk in that one partner may elect to delay negotiations about the amount of license fee to pay and so prevent the other partner from pursuing continued development. The agreement should therefore preferably include a provision stipulating that the partners shall agree on the amount of license fee within a specified time of, e.g. six months.

If within the time allowed no agreement is reached, either party shall be free to go to arbitration, although this shall not prevent the respective other party or parties from starting to use the one party's know-how in continued development. It may be well to add in this connection that the cooperation agreement should definitely contain an arbitration clause to obviate lengthy and costly litigation during and after cooperation.

TRANSFER OF KNOW-HOW TO A JOINT COMPANY

As mentioned, cooperation may also be induced by a customer wishing to charge several companies with a development task. This is often the case with military contracts, and also with large civil programs, such as the Airbus program or the European ARIANE rocket program, as well as with research contracts awarded by the Federal Ministry of Research and Technology.

With large-scale cooperative efforts, coordination of the various workshares is improved by forming a joint company of relatively moderate corporate net worth to pursue development and production on the basis of agreed proportional work inputs. This joint company, however, will own no know-how at the beginning of cooperation, nor will it gain any protectable know-how in the course of cooperation, considering that all know-how arises with the partners that founded the joint company.

In that case the partners should agree in the cooperation agreement to enable the joint company to be externally active, or to authorize it to use within mutually agreed limits the know-how available to the partners or developed during cooperation.

The author recommends the following wording to be used in the cooperation agreement:

"The partners agree to make available to the joint company X founded by them the know-how they have relative to the subject of cooperation before cooperation commences and that which arises in the course of cooperation and to allow the company X for the term of this agreement, nonrestricted, free, transferable rights of use in all inventions and any industrial rights and industrial rights applications resulting therefrom."

When a German company is involved, reference is made in this connection also to §§ 1 and 24 of the law against restraint of trade (GWB).

Its provisions require that—given certain premises ignored for the moment—the formation documents for a joint company must be filed with the Federal Antitrust Agency. The Federal Antitrust Agency must also be notified of mergers when made.

To be observed also are the provisions of article 85 of the EEC agreement and articles 4 and 5 of the decree No. 17 requiring intended mergers to be filed with the Brussels EEC Commission.

SUMMARY OF OPTIONS

1. The patents, industrial rights applications, ideas, proposals, design schemes and manufacturing instructions, as well as manufacturing processes, remain the unrestricted property of the partner who owns such patents, industrial rights applications, ideas, proposals, design schemes, manufacturing instructions and manufacturing processes and has entered them into the cooperative effort as of the date this agreement was executed.

2. Each party is entitled to use, for purposes of cooperation and without having to pay license fees, the patents, industrial rights applications and inventions entered in accordance with item 1.

3. Inventions made by company X during the term of this agreement in the performance of the work under this agreement shall be the property of company X.

4. Company X allows company Y for the term of the contractual relationship and for purposes of this agreement, free, *nontransferable* rights of use in such inventions and any granted or pending industrial rights resulting therefrom.

5. Inventions made by company Y during the term of this agreement in the performance of the work under this agreement shall be the property of company Y.

6. Company Y allows company X for the term of the contractual relationship and for purposes of this agreement, free, nontransferable rights of use in such inventions and any granted or pending industrial rights resulting therefrom.

7. Inventions arising during the performance of this cooperation and incorporating inventive contributions from employees of both partners (joint inventions), shall be filed for protection in its sole name by the partner having contributed the predominant portion of the invention.

8. If the partners are unable to agree on which party contributed the predominant portion of the invention, and if breakdown into separate protectable shares is prevented, the partner whose field of activity (see ... of this agreement) embraces the main object of the industrial right shall be entitled to file for industrial rights protection.

9. The partner filing for protection shall defray the costs of applying for and maintaining the industrial right.

10. The partners agree to jointly engage the services of a representative (patent attorney) for the pursuit of the application procedure, and for the defense, enforcement against infringers and maintenance of rights whenever joint inventions are involved.

11. Compensation for inventions, if payable by one partner to his inventors in accordance with the law, shall generally be defrayed by the partner who is commercially exploiting the invention involved. In the case of joint inventions the costs are distributed among the partners to reflect the use ratio.

12. Upon termination of the agreement the parties will allow each other at reasonable conditions, *transferable*, nonexclusive rights of use in the know-how made available to the partner or partners for cooperative purposes and in the field of cooperation, as well as in granted and/or pending industrial rights and inventions severally or jointly owned by partners. These rights, however, shall not include rights in the field of cooperation.

13. If a party to the agreement is desirous of using, in a field of application other than that of cooperation, patents and inventions made available to him by the other partner during the term of cooperation, the respective other partners shall agree in writing on, among others, the amount of license fee to pay in that case.

14. The partners agree to make available to the joint company X founded by them the know-how they have in the field of cooperation before cooperation commences, as well as that which may develop during cooperation, and to allow company X, for the duration of this agreement, a nonrestricted, free and transferable right of use in all inventions and what granted or pending industrial rights may result therefrom.