



Department of Energy

Washington, DC 20585

Date: August 28, 2006

Re: LICENSE ACQUISITION UPON CONTRACTING

When a contract for supplies or services is negotiated, the contractor sometimes proposes that patent royalties under a license agreement with a third party be recognized as allowable costs. The license agreement may be a pre-existing agreement, or it may be a proposed agreement that is to be entered into contemporaneously with the Government contract for the purpose of the contract work. This letter sets forth the policy to be followed in approving or rejecting such proposed license arrangements.

The legal authority for the Department to acquire patent licenses and, hence, to reimburse contractors for patent license costs, is described in the Appendix hereto. In summary, the Department has such legal authority for contracts not requiring patent indemnity under the Federal Acquisition Regulations (FAR). FAR (48 C.F.R.) §§ 27.204-206 deal generally with royalties under Government contracts, including procedures under which the Contracting Officer obtains advice on proposed royalty payments from Patent Counsel. However, the Department is not required to exercise the authority to acquire a license when it is not in the interest of the Government and may rely instead on the authorization and consent clause in the contract and the provisions of 28 U.S.C. § 1498 restricting a patent holder's remedy to an action in the Court of Federal Claims for "reasonable and entire compensation." Patent holders may also submit a claim to the Department under its administrative claim regulations at 10 C.F.R. § 782.

Policy

This instruction sets forth the policy of the Department for acquiring patent licenses upon contracting, for the work to be carried out under the contract. This includes the agreement to contract provisions under which a contractor is authorized to pay royalties to a third party patent holder and is reimbursed therefor.

(1) For contracts which are not required by the FAR to contain a patent indemnity clause, approval to agree to payment of royalties under a patent license agreement with a third party patent holder may be granted in accordance with the conditions set forth herein.

(2) For contracts requiring a patent indemnity clause and not satisfying the conditions for waiver of indemnity, no payment of royalties shall be agreed to because that would be contrary to the policy of the FAR to shift patent infringement liability to the contractor for contracts for standard parts and supplies and commercial services.



(3) For contracts otherwise requiring patent, indemnity but satisfying the conditions for waiver of indemnity, a royalty payment provision may be approved for the patents of third parties as to which indemnity is waived. Such a waiver of indemnity requires the written approval of the Secretary or designee (i.e., the Assistant General Counsel for Technology Transfer and Intellectual Property)(FAR § 27.203-6). In this case the proposed license agreement should be forwarded along with all other information to the Secretary or designee.

Regarding contracts not requiring patent indemnity and contracts as to which indemnity is waived, the Department's authority under 42 U.S.C. § 7261 to acquire patent licenses is not limited as to whether the Department's contractor has a pre-existing license or proposes to enter into the license at the time of contracting. However, the pre-existing status of a license is one of the indicia of the patent's licensing market value and represents the contractor's normal business arrangement. Also significant is the number of times the patent has been licensed. This also has a bearing on our ability to evaluate the proposed royalty. In cases where there is no established royalty rate for the patent(s) to be licensed, it is much harder to determine the reasonable royalty rate, and there is a much greater chance that the proposed royalty does not reflect a true market value. Therefore, proposed license agreements will be subjected to a higher level of review when the contractor does not have a license under an agreement antedating the contract solicitation, and the patent to be licensed does not have a substantial history of being licensed commercially. If the contractor does not have a pre-existing license (antedating the contract solicitation), the patent has never been licensed before (other than to a licensing organization), and the patent holder is demanding over \$100,000 in royalty payments, the patent holder is demanding over \$100,00 in royalty payments the patent holder's remedy shall be by filing an administrative claim or filing suit, unless the Assistant General Counsel for Technology Transfer and Intellectual Property waives this provision.

Procedure

In order to effectuate the foregoing policy in a practical and expeditious manner, proposed agreements with royalty payments of lesser amounts will be given lesser review. Accordingly, proposed patent license arrangements referred to Intellectual Property Counsel (IPC) by Contracting Officers shall be reviewed by the cognizant IPC in accordance with the following guidelines:

If the total license royalty during the license agreement is not expected to exceed \$10,000 and also does not exceed 10% of the contract amount,

1. The IPC shall investigate the patents to be licensed to determine if they have lapsed or expired or have been held invalid and to determine if they appear to cover the contract work;
2. At the IPC's request HQ shall search HQ and U.S. Patent and Trademark Office files to determine whether the Government already has a license; and
3. The IPC shall review the proposed license agreement to determine whether the license

requires the payment of a royalty and, if so, the amount of royalty that is allocable to the contract. The IPC shall also determine whether it is in the Government's interest to acquire a license and whether the license agreement is consistent with the policy set forth herein. If the proposed license agreement has not been finalized, the IPC shall review a draft of the agreement; If the total license royalty is over \$10,000 but does not exceed \$100,000 or exceeds 10% of the contract amount, in addition to 1-3 above,

4. The IPC shall review the patent claims in view of the patent's prosecution history to determine whether the contract work infringes the patents to be licensed;

5. The IPC shall perform or obtain a thorough patent validity study of the patents to be licensed. However, if the license royalty does not exceed \$50,000, a cursory study using on-line patent searching methods may be done. The IPC shall consider infringement and validity in arriving at a decision to pay royalty. If it is not possible to perform the patent validity study in time for the contract activity, the IPC shall withhold legal approval of the proposed agreement and consult HQ; and

6. The IPC shall determine whether the contractor has been licensed under the patent in question from a time before issuance of the contract solicitation. If not, the IPC shall thoroughly assess the reasonableness of the proposed royalty. The royalty rate at which the patent has been licensed in the past to third parties shall be the primary determinant of the reasonable royalty. However, it should be noted that awards by the Court of Federal Claims and its predecessors have rarely exceeded a royalty rate of 10%. If the patent has only been licensed once before, the IPC shall consider the rate at which similar technology is licensed commercially, the scope of the invention, the strength of the patent and the appropriateness of the royalty base. If the proposed royalty is not considered to be reasonable by the IPC or if the patent has never been licensed before (and the contractor is not under a pre-existing license), the IPC shall withhold legal approval and consult HQ

Royalties exceeding \$100,000

If the license royalty exceeds \$100,000, the IPC shall do the above and in addition shall withhold legal approval of the license until HQ concurrence is obtained. If a patent infringement and validity study and reasonable royalty assessment has not been done, HQ concurrence should not be anticipated. An agreement to pay royalties exceeding \$100,000 will not be approved if the contractor is not under a pre-existing license agreement, and the patent has never been licensed before (other than to a licensing organization). In these cases the Government's liability will be addressed through the administrative claims procedure and by contesting the patent holder's claim in court unless the Assistant General Counsel for Technology Transfer and Intellectual Property waives this limitation.

Review of License Agreement

In all cases, the IPC should examine the proposed license agreement to determine that it does not

contain inappropriate obligations on DOE's contractor or on the Government (e.g., grant-back clauses, nondisclosure provisions, and springing license termination clauses). The license should provide that in any event the licensor will not seek an injunction against the Government or DOE's contractor for the proposed contract work if the license fee is paid. In addition the royalty should be payable in increments as the work progresses or at the end of the work and never all at the beginning of the contract. The agreement should state that it does not constitute an admission of validity or infringement of the patent or that the royalty rate is reasonable.

The IPC should retain a copy of the license agreement and should report the following information to HQ so that HQ can be a clearinghouse for license information. The following should be reported:

- patent number
- date of license
- subject matter of license
- royalty (including royalty base)
- scope of license (paid-up or only for one contract)
- licensor
- licensee

In any case in which the licensor proposes to license the Department for use at multiple sites or Government-wide, the review or negotiation of the proposed agreement should be coordinated with HQ.

Of course, reimbursement of royalties paid is limited to royalties paid to third party patent licensors. In no case is payment of a patent royalty to a DOE contractor for use of its own patent to be approved. DOE has an implied license to use such patents, and there would be no consideration for an agreement to reimburse the contractor for paying a royalty to itself.

We believe that evaluation of royalty agreements should take place in advance of contracting even if the contract or license agreement includes a clause allowing the Government to challenge the validity or scope of the patent at a later date and to require repayment of royalties. In principle, postponing negotiation of important contract terms until after the contract is signed is unwise and in practice, would be likely to result in failure to review the royalty arrangement and patent. Any exception to this policy requires concurrence of the Assistant General Counsel for Technology Transfer and Intellectual Property. Note: There is no objection to the use of the Refund of Royalties clause of FAR §52.227-9, which limits compensable royalties to those that are properly chargeable to the Government and allocable to the contract. It requires the contractor to reimburse the Government for any royalties which the contractor is relieved of paying within 3 years after final payment under the contract. This clause may be modified to permit the Government to challenge patent infringement and validity and the reasonableness of the royalty.

This IPI does not attempt to give comprehensive guidance on when it is in the Government's

interest to acquire a license. In the words of the FAR, this shall be determined giving “due regard to all pertinent factors.” However, some considerations are set forth herein and the policy so indicated shall be followed while giving weight to any additional pertinent factor. The final decision to include contract provisions agreeing to the payment of royalties is made by the Contracting Officer with the advice of the IPC. The Contracting Officer is charged with determining that the overall arrangement is fair and reasonable.

Although this instruction allows royalty payments up to specified levels to be approved without a full blown patent study in order to accommodate the procurement process as much as possible, it may be that some offices will not be able to review proposed license agreements as required herein in a time frame desired by the contracting activity. In such cases and when a decision not to pay royalty is made, the contractor shall be advised to proceed with the contract work, and the patent holder will be left with the option of filing an administrative claim or a suit for money damages in the Court of Federal Claims. If the IPC is pressured to approve an agreement for payment of royalties that does not clearly come within the policy herein and/or cannot complete the review process described above within the time available, the IPC shall withhold approval of the agreement and refer it to HQ for review. As pointed out above, there is no requirement to agree to a royalty-bearing contractual arrangement. The Government has the statutory right to infringe patents and leave the patentee’s claim for compensation to the Court of Federal Claims or to disposition under the Department’s administrative claim regulations, at the choice of the patentee.

Research and Developed Contracts

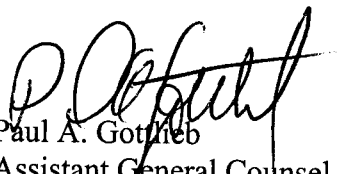
The foregoing license acquisition principles also apply to research and development contracts. According to FAR § 2.101. “Acquisition means the acquiring by contract with appropriated funds of supplies or services ...“the term “supplies or services” is generic to all acquisition. It includes research and development services.

As compared to damages for commercial activity, patent infringement liability for research (i.e. experimental use) has been held to be either zero or de minimis. It should be noted, however, that the courts may interpret "experimental use" in the infringement liability context very narrowly. With no current decisions under 14 U.S.C. Sec. 1498 which clearly define the measure of reasonable compensation under research contracts beyond de minimus damages, we maintain the position that damages would be, at most, nominal.

At the opposite end of the scale, a contract for standard supplies or commercially available services (not normally furnished under license) would require a patent indemnity clause and therefore would not be eligible for a patent license agreement.

The nature of the supplies and services and the Government’s use are factors to be considered by Intellectual Property Counsel in determining whether it is in the Government’s interest to take a license, what is a reasonable royalty, and whether the contract is for other than standard supplies

This IPI covers only patent licenses. Questions regarding licenses under other types of intellectual property may be referred to HQ.

A handwritten signature in black ink, appearing to read "P. A. Gottlieb", written over the printed name.

Paul A. Gottlieb
Assistant General Counsel for Technology Transfer
and Intellectual Property

APPENDIX

Background

1. While limited authorization for such agreements in the foregoing policy, it should be remembered that ownership of a patent or being licensed under a patent is not a basis for giving a preference to a contractor in a competitive procurement and cannot be the sole basis of a justification for noncompetitive procurement. This is called the Herbert Cooper rule after the case (Comp. Gen. Dec. B-136916, Aug. 25, 1958, 38 Comp. Gen. 276) in which the Comptroller General held that the Air Force's proposed rejection of a low bid because the bidder was not licensed would "constitute an improper restriction of competition" and was contrary to the purpose of 28 U.S.C. 1498(a). See also 48 C.F.R. §27.104(b) and (c). (Patent infringement does not preclude award of contract; authorization and consent to use of invention will be given.)
2. If the Government already has a license under patent and is obliged by agreement to pay royalties for practicing it, a contract solicitation should contain a notice of this fact and should also require offerors to furnish information indicating whether or not each offeror is a licensee under the patent or the patent owner. (48 C.F.R. § 52.227-7) "This information is necessary so that the Government may either (1) evaluate an offeror's price by adding an amount equal to the royalty, or (2) negotiate a price reduction with an offeror-licensee when the offeror is licensed under the same patent at a lower royalty rate". (48 C.F.R. § 27.204-3)

Authorities

Under 42 U.S.C. § 7261 the Secretary the Department of Energy (DOE) is authorized to acquire licenses under patents and patent applications if the subject matter thereof is to be used by or for, or is useful to, the Department. While there is inherent authority of the Government to contract, without this express authorization there might be a question of the authority to contract for a patent right in view of 28 U.S.C. § 1498 (which restricts a patent holder's remedy for infringement by or for the Government to an action in the Court of Federal Claims for reasonable compensation). This express authorization also eliminates the question of whether such authority was given to the Department of Energy by its constituent acts. When the agency enters into a contract agreeing to reimburse the contractor for royalty payments under a license under a patent covering the contract work, it is utilizing this authority to obtain (through the contractor) the benefit of license rights for the Government.

In the event that the Government does not have a license, and the contract work infringes the patent, the patentee may file an administrative claim with the Department under 10 C.F.R. Part 782 or may file suit against the Government in the Court of Federal Claims under 28 U.S.C. § 1498 for reasonable compensation in money damages. If the contract work is carried out with the authorization and consent of the Government, the Court will not issue an injunction against the Government. Consequently, the Government does not need a license to proceed with the contract work, but the Government may acquire a license or agree to reimburse a contractor for

its royalty payments under a license when it is in the Government's interest. It may be in the interest of the Government to acquire a license if the royalty is no more than would be awarded by the Court of Federal Claims and other considerations warrant licensing rather than relying on the Government's rights under 28 U.S.C. § 1498. An example of such other considerations is where the licensor is to furnish some significant information which it will only make available to a licensee. Future procurement may be a basis for negotiating a paid-up or running royalty license. In Metalstamp, Inc., Comp. Gen. B-147271, 1962 WL 3439 (Jan. 10, 1962) the Comptroller stated, "The Navy has also advised us that in view of future Navy requirements of the item involved, the Navy will consider the validity of the patent before the assertion of such [patent] claim in order to determine the propriety of initiating negotiations with you and your licensee for a license to the Government under the patent involved." (See also "To the Secretary of the Navy" B-127407, 35 Comp. Gen. 622, 1956 WL 1074 (May 4, 1956), authorizing the Navy to enter into a license.) Where the contractor has a pre-existing license agreement (antedating the contract solicitation) there is a compelling case that the Government should not force the contractor to abrogate its normal business arrangements since this could discourage competition for Government contracts by the most qualified contractors. However, in any case it is only in the Government's interest to pay a patent royalty when valid patents will be infringed.

The Federal Acquisition Regulations (FAR) at 48 C.F.R § 27.201-2 prescribes an Authorization and Consent Clause of § 52.227-1 for contracts within the United States (except those using implied acquisition procedures). This clause confirms the fact that the contract work is authorized and consented to by the Government. Without the clause, authorization and consent generally would be implied for work in conformity with the contract statement of work. However, with the clause in the contract, it is clear that the contract work cannot be enjoined. The use of the Authorization and Consent Clause is not inconsistent with requiring a patent indemnity from the contractor. (§ 27.201-1)

The FAR at § 27.203 requires certain contracts to contain provisions under which the contractor indemnifies the Government for liability for patent infringement. These are defined in the FAR but may be referred to generally as contracts for standard parts and supplies and commercial services. Other contracts do not require patent indemnity. For contracts that do require patent indemnity, the Government may waive indemnity at the time of contracting for specific patents with the written approval of the Secretary or designee if it is "in the Government's interest." (§ 27.203-6) An example of a situation in which it might be in the Government's interest to waive indemnity for specific patents is where the contractor is essential to the Government program and refuses to indemnify the Government without an inordinate increase in the contract price, and the Government upon study of the patents believes it has defenses to patent infringement (invalidity, lack of infringement, Government license or right to title) and can successfully defend an infringement claim by the patentee or obtain a license from the patentee at less cost than the cost of obtaining the contractor's indemnity. For purposes of waiver of patent indemnity, the Secretary's designee is the Assistant General Counsel for Technology Transfer and Intellectual Property. Of course, it would be inconsistent with the competitive bidding process to waive indemnity in a contract awarded by sealed bidding where the

solicitation required patent indemnity without a waiver. In subcontracts under management and operating contracts, the policy followed should be the same as if the Government were awarding a contract.

The FAR also provides that royalty information should be sought in negotiated procurement and submitted to the office having cognizance of patent matters for evaluation of all pertinent factors. "If the response to a solicitation includes a charge for royalties, the contracting officer shall, before award of the contract, forward the information relating to proposed payments of royalties to the office having cognizance of patent matters for contracting activity concerned. The cognizant office shall promptly advise the contracting officer of appropriate action. Before award, the contracting officer shall take action to protect the Government's interest with respect to such royalties, giving due regard to all pertinent factors relating to the proposed contract and the advice of the cognizant office." (§ 27.204-1(b)) We read this as allowing payment of royalties in appropriate cases in negotiated contracts. The same policy applies to ordinary subcontracts except that contracting officer consent need not be withheld pending receipt of advice from the office having cognizance of patent matters. (§ 27.204-1 (c)) However, for subcontracts under management and operating contracts, prior DOE approval should be obtained.

In view of the foregoing FAR provisions on royalties, payment of royalties should not be inconsistent with FAR cost principles. §31.205-30 "Patent costs" cites invention disclosure preparation, prior art searching, patent prosecution, to the extent incurred as a requirement of a Government contract, and counseling services as allowable cost items and states, "Other than those for general counseling services, patent costs not required by the contract are unallowable." The patent cost items in this section are those connected with the contractor's costs for its own patents, rather than royalty payments under third party patents. Additionally, if provision is made in the contract for the payment of royalties, then royalty costs would be required by the contract. The Comptroller General has indicated that patent license costs are allowable costs (Acting Comptroller General Weitzel to the Secretary of the Army, B-117374, 33 Comp., Gen. 203, 1953 WL 583 (Nov. 4, 1953); Acting Comptroller General Elliott to the Secretary of State, B-32960, 22 Comp. Gen 904, 1943 WL 900 (Mar. 16, 1943)). Patent infringement litigation costs, however, are not allowable unless otherwise provided in the contract (§ 31.205-47 (f)(6)).

After award, royalty reports are to be submitted by the contractor and transmitted to the office having cognizance of patent matters for the contracting activity concerned for advice as to appropriate action. (§ 27.204-1(d)) Since any such royalties should have been evaluated at the time of contracting, the royalty reports would normally not require a patent study. Rather, they would be examined to determined if they were consistent with the license that had already been approved.

Section 27.204-2 (Reporting of royalties - anticipated or paid) prescribes the Royalty Information Clause of § 52.227-6 for solicitations for negotiated procurement to obtain detailed information for evaluation of a license when more than \$250 in royalties will be payable.

When the contract is a negotiated fixed price contract containing royalties as an element of cost, § 27.206-1 provides that the Refund of Royalties Clause of § 52.227-9 be used in the contract. For DOE § 927.206 specifies the clause of § 952.227-9. This clause limits the royalties compensable to those properly chargeable to the Government and allocable to the contract and requires the contractor to pay back any royalties if it is relieved of payment of the royalties within 3 years after payment under the contract. In a sealed bid type contract (i.e., fixed price contract competitively awarded to the lowest responsible, responsive bidder), the Government does not look behind the bid amount to determine if there is a royalty.

While the FAR recognizes and makes allowance for royalties to be paid under negotiated Government contracts, it does not require the Government to agree to pay royalties. The Government may instead rely on the authorization and consent clause of the contract to ensure that the contract work will not be enjoined even through the Government does not have a license under any applicable patents. In Rel-Reeves, Inc. v. United States, 534 F. 2d 274, 298, 186 U.S.P.Q. 21, 40-41 (1976) the Court of Claims cited the explanation of this right from the Herbert Cooper case, “In fact, in 38 Comp. Gen. 276, 278 (1958), the Comptroller General has ruled that the availability of 28 U.S.C. § 1498 as a remedy for a patent owner requires the Government to accept advertised bids which are alleged to infringe a patent:

It is our view, however, that section 1498 appears clearly to constitute a modification of the patent law by limiting the rights of patentees insofar as procurement of supplies by the Government may be concerned, and by vesting in the Government a right to the use of any patents granted by it upon payment of reasonable compensation for such use. We believe that the statute is not consistent with any duty on the part of a contracting agency of the Government to protect the interests of patentees or licensees with respect to articles which it proposed to purchase, since the statute itself defines and provides an exclusive remedy for enforcement of the patentee’s rights as to the Government. Any other interpretation would appear to us to impose an impossible burden upon the Government procurement officials to determine the applicability and validity of any patents affecting any articles desired.”

Patent Indemnity

The Government policy of requiring contractors to indemnify the Government for patent infringement liability is a factor limiting the use of Government authority to enter into license agreements. The Comptroller General policy against making patents a factor in the award of contracts was explained in the Herbert Cooper case (and cited as Government policy in Motorola, Inc. V. U.S., 729 F.2d 765, 221 U.S.P.Q.297, 302 (Fed.Cir. 1984) as follows:

It must be assumed that the authorization and consent clause was included for the purpose of invoking the provisions of section 1498, Title 28, United States Code,

so that, in conjunction with a bidder's required agreement to indemnify the United States against loss, all bids would be for consideration on a common basis, whether or not the equipment which the Government desired to purchase could be produced by some of the bidders without infringing one or more existing patents.

In 1966, NASA adopted a policy of "preprocurement licensing," under which a license was negotiated before unauthorized use of a patent occurred, and the license costs would be added to the bids of unlicensed bidders. "Other agencies also considered this policy but rejected it. DOD was evidently concerned with the effect of this policy on their patent indemnity policy." Nash and Rawicz, Patents and Technical Data 324 (1983).

Since the Government paying royalties for use of a patented invention by a contractor is contrary to the policy of requiring the contractor to indemnify the Government for such costs, the FAR's implied authorization to pay royalties is construed as applicable only to those contracts not requiring patent indemnity under the FAR, except where a waiver of indemnity is justified. Therefore, contracts for standard parts and supplies and commercial services may not contain an agreement for the Government to pay a royalty unless the contract qualifies for a waiver of indemnity as to particular patents "in the Government's interest" as provided by § 27.203-6. For the purposes of this policy, "commercial services" does not include operations that are normally conducted under a standard process license agreement. For example, the Government may contract for the construction and operation of a coal gasification plant which uses coal gasification technology that is normally licensed by a process licensor under a standard process license agreement. The contractor may enter into a license agreement with the process licensor subject to the requirements of this policy and is not required separately to indemnify the Government with respect to the process licensor's patents.

Accordingly, acquisition of a license from a patentee or agreement to reimburse a contractor for royalty payments under a license agreement should only be approved for contract work not requiring patent indemnity when it is in the Government's interest.