

The patent pool licensor must maintain adequate records of income from the several licensees so that proper distribution can be made to the patent owners involved. In addition, the pool owner is obligated to see that the pool licenses do not violate antitrust or restraint-of-trade laws. Since this is an intricate area, the use of expert legal counsel in drafting and maintaining the license is an absolute necessity.

Some inventions lend themselves to the establishment of trademarks for the development and maintenance of optimum market potential. A trademark position can be established by either the licensor or the licensee, and may be in their mutual interest. The obligation of maintaining a trademark, at the least, involves maintenance of the trademark in the patent office and its assertion or defense against similar marks. Also required is continuous national advertising and the setting up of an adequate quality control system for the benefit of all licensees.

During the effective life of a license, license changes may be needed to protect mutual interests. They may become necessary because of unexpected production difficulties, shifts in expected markets, changes in corporate ownership, revisions of tax laws and so on. License changes may be initiated by either the licensee or the licensor. They most frequently involve modifications of the length of the exclusive period, the royalty base, royalty rate or minimum royalty.

#### Rights of Other Parties

The fourth and last category relates to the protection of the rights of others. When the inventor is a faculty member or university employee, the university generally asserts some rights to his invention. Since the institution is not interested in manufacturing products or using a process under license, its rights are usually satisfied through a royalty-sharing arrangement — whether or not it takes title to the invention. If co-inventors are involved, they usually share royalties according to some equitable formula.

In some cases, a company, university or inventor may use an outside organization, such as Research Corporation, for patenting and licensing. In this case, the usual procedure is to assign patent rights to that organization under terms of an assistance agreement calling for the sharing of royalty income.

No matter how many parties are involved, the licensor is obligated to maintain suitable financial records during the life of the license and pay out proper shares of royalties. Additionally, a written report of all licensing activities, usually on an annual basis, must be provided to the other parties in interest.

If some or all of the funding of the research that leads to an invention is provided by private charitable sources or governmental agencies, these granting bodies have certain rights which must be protected. Where governmental agencies provide aid, certain restrictions are imposed on patent ownership and licensing terms. The patent licensor is usually required to make sure the restrictions are observed and to make annual reports to the agency to insure adequate and prompt exploitation of any invention for the benefit of the public. Failure to exploit adequately frequently

leads to a recapture of patent ownership by the government. This is referred to as a "march-in right."

We have explored briefly a number of obligations that a licensor automatically assumes with the signing of a license agreement. These obligations must be met for the benefit of all parties to the license agreement. The scope and length of the list, which is by no means exhaustive, serves to indicate the diverse talents and disciplines needed by the licensor to fulfill his obligations after the license has been executed.

To some of us deeply involved in the evaluation, patenting and licensing of inventions, the most exciting part comes after the license is issued. At this point, the licensor must quickly become alert to all activities of the licensee and his competitors, exercise great diligence in recognizing and averting legal entanglements, develop and use imaginative solutions to unique problems, maximize return on capital assets, and insure prompt and widespread use of an invention which has been granted a temporary monopoly under the United States Constitution.

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### PATENTS AND LICENSES INVENTION LICENSING STRATEGY

by  
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*Seeking licensees and working out mutually satisfactory agreements with them, requires care, skill and an awareness of possible pitfalls.*

Licensing is the moment of truth for an invention. It is during licensing that an invention leaves its friendly, sheltered environment and must find its place in the world of business. Someone else must now be found who will share (and finance) the inventor's enthusiasms for the invention and carry through to commercial success. Thus, the licensing step must be executed with great care and skill. Failure at this point negates all that has gone before.

Typically, licensing involves the following vital elements:

#### Licensing Strategy

- Understand the invention and its significance
- Identify the potential market and its size
- Patent Protection
- Selection of licensee
- How many licensees

## License

## Key provisions

**The Invention and the Marketplace**

Understanding the invention and its significance involves a comprehension of the scientific accomplishment of the inventor. What breakthrough has the inventor made? What will the invention do that has not been done by existing technology? How does the invention improve present ways of accomplishing the same purpose; or, if it is a more basic invention, what will it replace and what benefits will industry receive by the replacement? In some cases, the uses for an invention are obvious. In other cases, where the uses of the invention are more obscure, scientific experts should be utilized; and, even then, it is often many years until some important uses of an invention are identified. Sometimes a later invention will make an earlier one commercially interesting. An example is the combining of laser technology and holography. All potential uses should be identified as a prelude to market estimates.

The potential market must be identified as to its nature, and estimates of its size prepared. A market survey involving months of time and many thousands of dollars is not unusual in this stage of preparation for licensing. Here information about the use of the invention is utilized to arrive at estimates of economic potential of the invention to a licensee.

The invention will be subjected to a critical analysis by any prospective licensee in order to estimate the size of future investment to bring the invention to the marketplace, and what the return on investment might be. At the stage of development of many inventions, such estimates come close to being little better than educated guesses. But, nevertheless, the best estimates at the time should be obtained and presented to potential licensees.

In the case of inventions developed under government funding, a question that must be answered is: will the U.S. Government be the only significant user of the invention during the expected life of the patents; and, if so, does the Government already have royalty-free rights and privileges? If the answer to this inquiry is yes, then the invention has little or no economic value to the inventor.

Yet another critical element of licensing strategy is obtaining patent protection. As a minimum, patent protection should be obtained in the United States. With today's global economy, this is only a start. Patents should be obtained in all countries where the invention will have substantial use of manufacture. Here, the market plan is utilized in dictating where patent applications should be filed. A patent application should be on file before license discussions are initiated, so that the inventor's rights are clearly established.

**Selection of Licensee**

Once the uses for an invention have been identified and the potential market estimated, it is then possible to identify candidate licensees. Unless the invention is interwoven with the proprietary rights or position

of one company, it is usually wise to consider and discuss, in a preliminary way, the licensing of the invention with more than one prospect. In this regard, candidate licensees should be selected in each of the following categories:

1. Companies who are in the direct line of business to which the invention applies.

2. Companies who could logically extend their business activity into the area of the invention and who are currently marketing products in a closely related field. (As an example, a company that is in the brewing business should be considered as a prospective licensee for a new snack food.)

3. Companies that are not currently in the field or related fields of the invention but who have the resources, people, and money which, if applied to the invention, could make the company an important factor in this line of business. This general description could fit many of our important corporations today and, more and more, these companies are organizing internally in a way that they can effectively apply their corporate resources to a new-product area. Most of the top 500 companies now have new product departments and are continually searching for new things. Printed listings and descriptions of inventions that are available for license are frequently used in searching for licensees.

Another important consideration in licensing strategy is the number of licenses to be granted. Should the license be exclusive? And what geographical areas should it cover? Most licensees like to have an exclusive license. Certainly, in some cases it is the only basis on which the invention can be licensed. Such a case is one in which a substantial investment must be made by the licensee before he can reach the marketplace with his product.

On the other hand, the licensor may feel more comfortable if he has more than one licensee attempting to make a success of the invention in the marketplace. If the invention had its origin under a Government contract, the provisions of the contract should be examined to determine what restrictions, if any, the Government has imposed on the ability to grant an exclusive license. Even exclusive licenses do not have to be for the entire life of the patent that covers the invention. The licensor might be wise to provide that the license eventually becomes nonexclusive to permit broader expansion of the sales of the product after introduction of the product.

Another potential trap for the licensor is to include in any license arrangement geographical areas that the licensee is not capable of reaching with the product. Again, licensees are quick to ask for the entire world for their marketing area, even though they may never have sold any of their products in certain areas or countries, and, in fact, would have extreme difficulty in doing so within a reasonable time period into the future. Therefore, the licensor should seriously consider finding potential licensees in different geographical areas of the world since that area may best be serviced by a local company. Some logical geographical divisions present themselves — such as North America, South America, Europe and Great Britain, and the Far East.

With the easing of East-West tensions and the encouragement of trade, a fifth area, the Communist-block countries, might soon have to be added to the above. Sound strategy would thus include studying each potential licensee and the geographical area that he can cover and then simultaneous licensing in each of the geographical divisions.

#### Key License Provisions

Having selected potential licensees, a license must now come into being. A patent is the right to exclude others from practicing a carefully defined area of technology. The license is an agreement or contract by which the invention owner now authorizes another party to practice the invention in accordance with the terms set forth in that agreement. There are many books on the preparation and content of license agreements, including suggested clauses to be included in agreements, as well as check lists to be used in determining whether an agreement has covered all of the key points. Simply stated, however, the sole purpose of the license agreement is to set forth the understandings of the parties to the agreement in language that is clear to both. The actual drafting of a license should obviously be left to one who is a specialist in this area. There are certain key areas that the agreement should cover. It should clearly describe exactly what rights and privileges the licensor is granting to the licensee. Can the licensee make, use, and sell? Is the license exclusive or nonexclusive? Will the licensee have the right to sublicense? What patents of the licensor are being included? Are future improvement inventions of the licensor or licensee to be included, etc.?

Of primary importance is the question of how the licensor will share in the commercial success of the invention through the activities of the licensee? On what basis will royalties be paid? The base on which the royalties are to be computed should be clearly set forth, and the time when payments are to be made should be specified. The amount of royalties paid must be fair to both parties. The royalty cannot be so high as to impede the sale of the product and reduce the opportunities to the licensee, nor can the royalty be so low as to not represent a fair return to the licensor for his risk in handling the invention. A rough rule of thumb is that if the invention results in a \$1.00 cost saving to the licensee over other or previous methods used, the licensor should receive between \$0.25 and \$0.33 of that dollar as his share. From this rough rule, the royalty formula can be established in a way to meet the accounting convenience of the licensee so long as the application of the formula yields the appropriate payment to the licensor.

The license agreement should establish some criterion or criteria for future performance on the part of the licensee. Since the goal of the licensor is to have the invention utilized, he cannot tolerate a licensee that is not obligated to bring the invention to the marketplace and is not under penalty if he fails to do so. Payment of a license fee at the time of signing, even though relatively nominal, will assure that the agreement has been reviewed by appropriate officials

of the licensee and that, at the time of signing, there is a clear intent to go forward.

Prior to the time that the licensee is expected to be in production, diligence on his part should be defined in terms of development effort and expenditures, and operation of pilot plant or prototype equipment and facilities. After the date when it is assumed that the licensee will be in production and making and selling products based on the invention, the agreement should specify minimum royalties that are not a hardship on the licensee but would certainly be painful to pay if his commercial activity were seriously lagging or non-existent. Failure of the licensee to meet any of these diligence requirements would form the basis for the licensor to either terminate the agreement or to convert it to a nonexclusive license if the agreement had previously been exclusive.

The parties to the license should establish how they can get divorced if they have become disenchanted with the arrangement for one reason or another. A licensee who is no longer interested in making, using, or selling the invention should be permitted to terminate the agreement at the earliest possible date with no obligation beyond that date. This assumes that a disenchanted licensee can do more harm than good in the marketplace for the invention. To have the invention attain commercial success, a dynamic and aggressive licensee is needed, not a reluctant one.

As stated at the beginning, licensing is a most important step in the bringing of an invention to the marketplace so that the public may benefit. At the same time, income is generated to advance the purposes of the inventor or invention producing organization. Licensing is a complex task. All the efforts and investment of time and funds that brought the invention to the point of licensing can be lost, or significantly diminished if the licensing is not competently performed.

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