# Pitfalls in Licensing

*A discussion of hints and suggestions which may help in concluding successful arrangements*

**BY M. P. JACKSON***

There are two general difficulties on this subject, one the plethora of available information and the other establishing a logical progression from point to point. These difficulties are to some extent at least also present in many a licensing negotiation, but hopefully the following thoughts and comments will be useful and lead to an interesting and informative discussion.

*Bibliography*

The LES Bibliography of books and articles on licensing is extensive and well worth consideration. In many ways more interesting, though, is a browse through the "Contents" pages of the *Les Nouvelles* issues. The journal has been published for over 10 years now and it contains numerous articles of direct relevance to the present subject. Indeed, nearly every statement can be interpreted to imply, if not actually state specifically, some particular pitfall.

Articles of special merit from this point of view are:

| DATE | TITLE | AUTHOR(S) |
|---|---|---|
| 1) Jan. 1968 | Licensing — the positive approach | C. T. Cross |
| 2) Jan. 1969 | Licensing for fun and profit | H. D. Moran |
| 3) Nov. 1969 | Business aspects of licensing | A dialogue between Mr. Business Executive and His Counsellor |
| 4) May 1970 | Licensing pitfalls to avoid in view of recent Government antitrust action (in the U.S.A.) | G. P. Smith |
| 5) Sept. 1970 | The importance of licensing | Dr. B. J. A. Bard |
| 6) June 1972 | Licensing a consumer product | Dr. S. Spiegel |
| 7) Sept. 1972 | The small companies' view of licensing | N. A. Jacobs |
| 8) Dec. 1972 | Licensing and law | T. C. Clark |
| 9) Mar. 1973 | Patents and licenses — invention licensing strategy | V. E. Young |
| 10) Mar. 1973 | Patents and licenses — servicing the existing license | W. Marcy |
| 11) June 1973 | Some snappy real life do's and dont's | D. R. Sadler |
| 12) Sept. 1974 | Evaluating a potential licensee | D. N. King |
| 13) Dec. 1975 | Proper use of patent misuse doctrine | J. H. Wallace Jr. |
| 14) Mar. 1976 | Deciding on products to be licensed | E. M. Lang |

It is notable that two of these papers were by people connected with Battelle (Mr. Moran and Mr. Young) and two by National Research and Development Corporation

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people (Dr. Bard, now no longer with the Corporation, and Mr. King). Maybe they were able from their nonindustrial positions to achieve a broader perspective when considering the subject.

*Think Broadly*

This in reverse is the first and perhaps the most important pitfall to be mentioned. It is essential the negotiators and all others involved in a licensing operation should not think narrowly and only of the immediate problems. They must think broadly and comprehensively so as to ensure that all possibly relevant aspects, both current and future, are duly considered at the appropriate times. This is necessary as much during the operation of the license as it is during the negotiations leading to the arrangement. The licensor and licensee have in many instances a continuing relationship and it is invariably closer than that of a vendor and a purchaser. A licensor sells his technology and can be said to "buy" the licensee's outlets whilst the licensee sells his capabilities and buys the technology. Just one inadvertent or ill-considered word or deed can have many repercussions.

*Think Flexibly*

It is also essential to avoid adopting at too early a stage a set stance. The other side operates in a climate which is almost certainly different in many respects to one's own and it is necessary to investigate the reasons for the different posture before deciding one's own definitive attitude to a particular point. It may be that the experiences of the other side will contribute much to maximizing the effectiveness of the final arrangement.



Another aspect of flexibility arises when the two sides speak different languages. Often the same words can be used but to mean different things, and much confusion can occur if care and thoughtfulness are not employed. I think it was George Bernard Shaw who said, "The Americans and British are two great nations separated by a common language!"

*Consult Fully*

There must be a full dialogue both between the negotiators and between each side and the colleagues in their respective organization. It should be remembered that licensing invariably involves the research and development, production, marketing, finance, legal and personnel facets, and all these need to be considered in appropriate depth. This might be more difficult, but in many senses is therefore more important, in a large multidisciplinary company. The licensor, for example, needs to confirm that not only is the technology and relevant documentation available but that suitably competent technicians are also ready to provide the necessary support. Similarly, the licensee must check that its staff has the capacity to absorb and operate the technology effectively or it must inevitably recruit appropriate experts. Again certain of the staff may be demotivated by licensing-in or licensing-out, either operation may require adjustments of company priorities, and these probably will need to be reflected within the company activities and within the license arrangement itself. Invariably it will be necessary to adopt a gradual step-by-step approach. There may even need to be a sequence of agreements expanding from a limited disclosure to some collaboration and eventually a full licensing agreement.

*Consult Continuously*

Many licensing arrangements have continuing provisions such as routine reporting, technical exchanges, and grant-back of rights on improvements. Even when these are not present, the licensor will be anxious to know that its technology is proving effective and is being operated fully, whilst the licensee will be keen to establish that it is obtaining maximum benefit under the arrangement. Hence both sides have much to gain from frequent and continuous consultation. This is particularly so when both sides are using the technology and thus are constantly learning more.

*Remember Third Parties*

It is doubtless a truism, but one which is stated all too rarely, that the licensor and licensee must both ensure that they do not, as a result of the license, find themselves in a worse position than their competitors and other third parties in the marketplace. There is no reason other than poor negotiating for a licensee under a know-how deal to be under a continuing secrecy obligation when the licensor or a third party has published the information on which the deal was based. Of course, often all the information is not published, but then one can invariably separate out that which is still secret.

*Maintain Current Awareness*

Current awareness is essential on all facets and at all levels. A better product or process may emerge; the technology may be rendered obsolete, let alone improved; and adequate termination provisions could be essential. Restrictions may be placed on overseas investments, or tariff or other barriers may be raised, and again one must react positively and quickly, but this can only be achieved if one is fully informed, has an adequately drafted agreement and, on the occasions when necessary, preferably a continuing good relationship with the other side.

*Legal Developments*

Even more important nowadays is a very reliable current awareness of legal developments. Gone are the days, it seems, when one could consider the statute and case law at some length, then decide on a particular course of action. Decisions or sometimes even suggestions can be sufficient to cause a re-think of current negotiations or reassessment of agreements already in force. In the U.S.A. practitioners learned to live with this type of situation during the early 1960s but in Europe the process has started only recently. The nonenforceability of the "no-attack-against-validity" provision is probably the best example of this.

*International Organizations*

One must also keep aware of the UNIDO, UNCTAD,

and WIPO activities. There are Model Laws, Codes of Conduct and other proposals, many in an advanced stage of drafting, which will have many effects on the activities of licensing practitioners. These effects will be felt both directly and indirectly as countries, and not necessarily only the so-called developing countries, modify their laws to conform with the internationally-sponsored ideas, whether or not these are likely to lead to a more effective technology transfer flow.

*Operations under License*

Perhaps the most difficult legal development recently for the British to come to terms with is the concept in the European Community of applying so fully the consideration of what actually happens in the marketplace. One can have a legal document setting out in precise and full terms all the provisions of an agreement and these can all be entirely correct and proper, i.e. within all the relevant legal requirements, yet this will be no defense against an allegation of anticompetitive operation if the actual activities in the marketplace are so conducted as to have an anticompetitive effect. Thus it is essential to maintain current awareness not only of the legal developments as they occur but also of the actual operations under agreements so as to be able to advise and guide one's commercial colleagues on the best courses of action to adopt at any particular time.

*Costs*

Licensing is often regarded as an effective means of gaining time by avoiding the development period which would elapse if the work were done in-house, and in the 1960s the U.S. Institute for Corporate Diversification "estimated that the cost of identifying suitable new products developed elsewhere is about 2% of the cost of making similar developments internally"; also it seems "Du-Pont, 3M Company and Monsanto, industrial giants usually considered thoroughly self-sufficient, draw more than half of their combined profits from products invented outside their organizations" (both quotations from paper 2 above). Yet in the same paper, Mr. Moran also emphasized that Battelle early on acquired some rights to the basic xerography work and then achieved several major development improvements without which the technique might never have been established and Chester Carlson could conceivably not have become a multimillionaire. It is therefore very necessary to assess the reliability, reproducibility, and completeness of the technology, analyze the potential costs of the various requirements, and keep a close watch on the running costs, especially those further development and servicing costs which are often hidden but can become very expensive — for example, those of management and expert time, as well as the costs of the licensing activity itself.

*Definitions, Drafting*

The legal document setting out the various provisions of the agreement is, of course, of paramount importance and must be prepared with much thought and care. Time and again one is surprised at the difference a slight modification of wording or even punctuation can have, sometimes of immediate financial significance. Each phrase, each definition, each provision must be viewed in relation to the particular circumstances and certainly not used just because it is a convenient precedent which has been accepted and found suitable on previous occasions.

*Adaptability, Benefit, Compromise, Decision*

There are several recurrent thoughts and themes which have prompted many of the points in this paper:

a. One must constantly be prepared to adapt one's attitudes to an ever-evolving and ever-changing situation; this is so in any business activity, but particularly in the area of licensing.

b. One must bear in mind that, whilst there must be benefit for one's side, it is most desirable that there are mutual benefits so that both sides gain from the arrangement; this is particularly so in cross-licensing and continuing collaboration arrangements.

c. Compromise must inevitably figure highly as the negotiations and operations proceed since it would indeed be most remarkable if both sides started out with exactly the same attitudes on all aspects.

d. Many of the decisions, especially on the precise terms of the licensing agreement, will be required before all the necessary facts are or could be available, but this simply emphasizes how important it is that the current knowledge is collected and assessed together with reasoned and balanced predictions so that the decisions are as soundly based as possible.

Hence an A, B, C, D which might conveniently be remembered is "adaptability, benefit, compromise, decision."



*Conclusion*

Another case history referred to by Mr. Moran (paper 2 above) illustrates many of the points in this paper, particularly for those with a patent background. Licensing has been defined as maximizing the return on development investment and, of course, part of this is to increase market penetration without creating or strengthening a competitor to one's own overall disadvantage. Again much is said nowadays about achieving full utilization of the byproducts of research and development. A strong patent position is invariably thought to provide the best basis for licensing, yet it "can be a deterrent. As an example, when CBS developed the 33-1/3 record, they did not patent this technology; it was in the firm's best commercial interest *not* to restrict the use of LP knowledge but to *expand* it, and both CBS and NBC — the latter with the 45 RPM system — even paid subsidies to phonograph manufacturers to encourage introduction of equipment which could play their new records." A superb example of "adaptability, benefit, compromise and decision."

One caveat — no claim is made that all the points in this paper are consistent with one another. Almost by definition this is impossible. Indeed it is one of the constant joys or despairs of licensing!