How to Meet Program Goals In License

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Key issues to include in the license you write; first step is get a clear understanding of needs, objectives

The subject matter of this paper assumes that the "business people" representing the licensor and licensee have reached "an agreement in principle" with respect to the intellectual property rights (IPR) that are to be licensed and possibly some of the other terms of a proposed agreement. Your job is to prepare a license agreement that embodies the terms that the parties believe they have agreed to. The key issues to be discussed are applicable to global or worldwide licensing programs and not the standard or boilerplate provisions.

Key Objectives

Before you even begin an outline for a new license and before resorting to a plethora of form books and form agreements for licensing technology, you should sit down with your clients, the business people for whom you are going to reduce the agreement, or "intent of the parties" into a written document. Spend some time with your clients to determine their expectations with regard to the licensing program.

What are the key objectives or goals of the program? Are they trying to develop international brand recognition? Are they trying to license an invention to maximize short-term royalties or seek the assistance of others to develop practical applications? Are they attempting to resurrect a trademark that is on the brink of becoming generic? Your strategies and the particular terms selected to implement these strategies will depend upon the overall goals.

Hybrid License Agreements

A "hybrid license" is a term often applied to an agreement in which an invention or patent is being licensed in conjunction with some significant know-how that may make the use of the invention possible or more profitable. Generally, the "know-how" may be a trade secret or a form of knowledge that is not protectable by one of the traditional forms of statutory protection. A hybrid license agreement could also refer to a license involving patents and other forms of intellectual property that can be protected by statute, such as a trademark.

In any case, the licensor's right to collect royalties for the patented technology, under U.S. law, ends with the expiration of the relevant patents. This consideration, however, certainly may not be the same in countries in which it may be necessary to obtain government approval of the license. Other countries or governments have foreign investment agencies that must approve the royalty structure in certain circumstances. In these situations, it is essential to determine the specific needs of the various jurisdiction where the licensee's use or sales may occur and to propose financial terms that will be acceptable to the appropriate government authorities.

Contractual Restraints

There are many types of contractual limitations or constraints that the licensor may want to impose upon the licensee. Generally speaking, these restraints have one primary goal and that is to maximize the royalty stream. These may include the following:

- A requirement to pay royalties for unpatented items.
- Restraints on resale.
- Retail price maintenance.
- Territorial limitations.

Many of these types of restraints may be illegal in certain jurisdictions. In the United States, unfair restraint of trade and antitrust considerations refer to the primarily court-made laws dealing with unfair or unreasonable restrictions generally governed by the "rule of reason."

This is not, however, the case in many other foreign jurisdictions. In Japan, for example, the Fair Trade Commission provides regulations governing antitrust-type activities and specifically identify certain licensing restraints that are presumptively lawful or unlawful. Similar administrative agencies operate in Europe where, again, certain exemptions can be obtained from the European Commission. For example, group exemptions for patent and know-how licensing are available and an application can be made for a specific exemption.

Certain regulatory approval may be requested from the European Commission. For example, they can be requested to formally approve of the agreement or determine that it is clear under EC competition regulations. They can also be asked to determine whether the agreement fits within an "individual," "group," or "block" exemption, or they can be asked to grant an individual exemption or comfort letter. If the licensor intends to obtain such an exemption, the licensee should be required to cooperate fully with the licensor and take the necessary steps to achieve complete compliance with the EC regulations. Additional, self-serving

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terms, may be incorporated indicating that the licensee has agreed to the financial terms of the agreement and provide a business reason for such election. A typical statement would indicate that due to the nature of the business it is difficult or impossible for the licensee to control the countries in which the products are ultimately sold.

Field-of-Use Restrictions

A restriction on the field of use of a licensed intellectual property is one form of these contractual restraints. It often is one of the most important limitations in a license agreement. These are most often used in connection with trade secrets or inventions where there may be a large number of potential areas or fields in which the technology can be applied, but only one or a few are susceptible to commercial exploitation by a particular licensee. It may be that the licensee's area of technical expertise lies, for example, in the area of photographic equipment, such that the licensor would only want to grant rights to use the technology in the manufacture of such equipment. The licensor would obviously prefer to retain other fields or applications for licensing to other companies. This would similarly be true with respect to trademarks and copyrights where the ''bundle of rights'' is divided between a number of experienced licensors.

Worldwide Approach

In this modern age, IPR protection in a licensor's home country probably will not be sufficient. To maximize the return on investment, protection is generally sought in Europe and Pacific rim countries, even in what were once thought of as ''third world countries.'' Many companies have the technical and financial capability to manufacture an infringing product in a country where labor costs are low and export it to the end user. Therefore, if competitors in foreign countries are free to exploit the licensor's innovation and creativity and compete with your license, then certainly the value of your license is substantially diminished.

Therefore, within the statutory framework of the Patent, Trademark and Copyright Laws, licensors must plan in advance to build the protection that maximizes the value of the property or properties to be licensed. This planning and these filings often may occur or must occur well in advance of the emergence of a potential licensee or even a licensing program. Obviously, the adherence to the terms of the various multilateral international conventions can be of substantial assistance when seeking worldwide protection. The oldest of these and probably the most well known is the convention for the protection of industrial property, generally known as the ''Paris Convention.'' This agreement covers patents, industrial designs, trademarks, utility models, and unfair competition, and sets a prescribed priority period, twelve or six months, for filing additional applications in any ''convention country'' first has to file an application. All ''convention filings'' are treated in the convention countries as if they were filed on the priority date in that country. The ''Convention for the Protection of Literary and Artistic Works,'' generally known as the Bern convention, is the primary international convention with respect to copyright protection.

The relatively recent Patent Cooperation Treaty provides a streamlined system for the filing and examination of patent applications. A single international application branches into national phase applications for each of the countries originally designated by the applicant. Recently, the General Agreement on Tariffs and Trade (GATT) and Trade-Related Aspects of Intellectual Property Rights Including Trading Counterfeit Goods (TRIPS) also became a part of our arsenal to protect IPR. The World Trade Organization came into effect on January 1, 1995, to administer the basic rights and obligations of its member countries with respect to international transportation and shipment of goods and services.

By properly protecting its IPR, a company will enhance the value of its ''assets'' to a prospective licensee. The licensing program and the agreement should address all of these issues. Another key issue in many licensing programs relates to the potential grant by the licensee of sublicensees to third parties. This can come up in a situation where the first licensee may not have the resources or the financial wherewithal to properly exploit its license and he will want to grant rights to others in order to maximize sales. However, the owner of the intellectual property rights has a legitimate concern with respect to the selection of the sublicensees and will want to include restrictions such as the right to approve the selection of sublicensees.

THE MONEY: FINANCIAL TERMS MAY BE THE EASIEST

The financial terms are often the easiest terms to negotiate because the clients may have already reached an agreement as to some of the following issues.

Internal Information and Databases

In most cases, there will not be a typical or generally accepted specific royalty rate that is applicable to your particular situation. However, your client may have previous agreements and historical knowledge relating to the similar technology that is the subject matter of your agreement. Also, many firms involved in the licensing of technology maintain databases which will assist you in determining a reasonable royalty for the IPR being licensed.

External Sources

Many published sources of information are also available. One such publication entitled *''Royalty Rates for Technology''* is published by The Intellectual Property Research Association of Yardley, Pennsylvania. This publication and others provide a survey of royalty rates for a large number of industries and specific technologies. As one might expect, most royalty rates are under 10%.

Industry Standards and Margins

Known industry standards and profit margins provide additional sources that should be considered when negotiating the overall cost or fees to be paid by the licensee. It is generally accepted that higher royalties will be paid in connection with the technology that has substantial research and development efforts to create. An example of this is the health care field where, in addition to research and development expenses, additional expenses in connection with obtaining regulatory approval indicate that a higher rate would be appropriate. Similarly, when licensing the use of a trademark on commodities, such as wearing apparel, where the value of the commodity is substantially enhanced by the license and likewise the profitability of the sales, higher license fees can be expected to be "reasonable."

Royalty Rates

The actual "royalty rate" is only one of the financial terms in a typical license agreement, but it provides the basis for a starting point for many of the other financial considerations. For example, royalty rates often start as an initial, relatively higher rate, and may decrease over time in response to other factors. Typically, royalty rates decline as sales of the licensed products increase, thereby providing an incentive for the licensee to increase sales. The licensor's interest, on the other hand, in order to increase its revenues, is to set the thresholds, where royalties only decline at relatively high, but realistic limits.

Timing of Payments

The terms governing the timing of the royalty payments from the licensee to the licensor necessarily include a "time value of money" component. This leads the licensor to desire that payments be made as soon as possible while the licensee desires to postpone required payments as long as possible. Obviously, other factors must be considered, for example, because, if the royalties are calculated as a function of the number of sales, the licensee must be able to determine how many sales were made before a royalty calculation can even be made. The most common royalty terms usually require the payment of royalties based on sales for a particular three-month period. Typically, the licensee is given 30 days thereafter to determine the number and types of sales that have occurred and to make a royalty payment based on those sales.

Another factor that sometimes is considered a "timing" issue relates to advanced royalty payments. Typically, the licensor desires to have a sizable upfront payment which is characterized as a "royalty advance." Its benefits include the fact that it receives royalty payments earlier and it provides an incentive to the licensee to manufacture or sell the products covered by the license agreement. The advance royalty term can also be used for other reasons. For example, an advance royalty can be used as a "annual minimum royalty" that can result in the agreement, for example, becoming a nonexclusive license if the original, exclusive licensee fails to meet a certain threshold on an annual basis. In this situation, the licensee can maintain its exclusivity by making the annual minimum royalty payment. It is important to consider all of these factors when setting the "royalty rate" because all of them affect the overall cost to the licensee and the revenues to the licensor.

Audit Provisions

Audit provisions permit the licensor, usually on an annual basis, to audit the books and records of the licensee to insure that the proper amount of royalty is being paid. While these provisions were often objected to by licensees in the past, they are now very commonplace as long as the entity hired to perform the audit is a "independent third party." Most of the time when an audit uncovers a discrepancy, it is usually a result of an unintentional error on the licensee's part with respect to the treatment of certain sales, such as when they occurred or an incorrect treatment of credits, such as returns. However, since it usually takes time to conduct an audit, the licensor will want to receive an interest payment on top of any additional royalties due, since they are being paid at a later point in time.

FAIRNESS: PROTECTION OF EACH PARTY'S INTEREST

Indemnification

Each party to an agreement wishes to be insulated from liability generated by the other party. The licensee wants to be protected from charges of infringement by a third party, while the licensor wants protection from damages or other claims as a result of the licensee's activities. The licensor may require that the licensee purchase insurance having certain described limits adequate to cover its potential liability. Typically, a small licensee may not have the financial resources to provide the desired indemnification.

Defending of Intellectual Property Rights

The licensee also will want assurances from the licensor that the licensed intellectual property rights will not infringe third-party rights. With respect to both indemnification and defense, the licensor wants to control the defense and any settlement negotiations and presumably will want to accept no liability other than for infringement of pre-existing rights.

Enforcement of Rights

Another key issue is enforcement of the licensed intellectual property rights. If the licensor is unwilling to take the necessary steps to enforce its rights, the licensee is at a significant financial disadvantage, *vis a vis* third party infringers who complete in the marketplace. "Why should he be paying licensing fees when others are not?" Although the licensee expects assistance from the licensor and enforcement of the licensed intellectual property rights, the licensor will not be inclined to litigate nuisance claims at the request of the licensee. Therefore, some objective measurement of the effect of the infringer's activities should be included and, typically, a royalty rate reduction may be applicable during a period of time where substantial infringements are occurring.

Liability Limitations

The licensee is desirous of obtaining unlimited indemnification with respect to alleged infringements. However, the licensee wants to have a reasonable limit on its exposure commensurate with the total amount of income to be derived from the license. A typical limit often ranges between 50% and 100% of the total royalties previously paid.

Most-Favored Licensee Terms

Another key factor that most licensees will want is a guarantee that they are being treated fairly, *vis a vis* other licensees. This typically arises in a situation where a prior nonexclusive license has been granted to one party and a second, potential licensee, is seeking terms that are more favorable than those previously granted to the former licensee. Because of this possibility, the prior licensees will want provisions in their agreement that will cause various terms to automatically change if more favorable terms are granted to a subsequent licensee. Therefore, when drafting agreements for both the first licensee and subsequent licensees, it is important to know how different terms may affect the rights and obligations of other lieensees.

Exclusive or Nonexclusive

In determining whether an exclusive or nonexclusive license is to be granted depends upon the licensing program, but it will undoubtedly affect other factors in the agreement. Obviously, if an exclusive license is to be granted, higher royalty rates and higher minimum royalties would be expected.

Grantback Provisions

Grantback provisions are usually favored by the licensor as a method of enhancing its "asset value" in a licensed technology. Typically, the licensor is desirous of obtaining ownership to any subsequent inventions made by the licensee during the term of the license. The licensee, on the other hand, would prefer to retain ownership of any inventions or improvements made by its employees. Fairness suggests the adoption of a middle-of-the-road approach, such as co-ownership of subsequent inventions or the right of the licensee to use the improvements without the payment of additional royalties. Obviously, if the term of the license agreement and the commensurate duty to pay royalties is extended because of new patents or innovations developed by the licensee, there is little incentive on the licensee's part, to assist in the procurement of additional patents which only benefit the licensor.

Continuing Duty to Update

Update requirements provide assistance to the licensor in that they require the licensee to divulge improvements that it has developed or become aware of. In order to fully exploit the technology it has developed, the licensor will want the licensee to keep it appraised of new developments.

DEAL BREAKERS: LEVEL OF PAIN

There are always certain issues that, no matter how reasonable the term may be, are absolutely unacceptable to one party or the other and will prevent the deal from being consummated. Sometimes, one party's position may be absolutely incomprehensible or totally illogical to the other party, but in any event, presents a situation where there is absolutely no flexibility. In this section, I wanted to discuss how to approach these issues and head off a possible impasse.

Preparation

You should be fully prepared at the outset when negotiating the final terms of a contract. Know your client's position with respect to the "deal breakers" so that you both understand them and can explain your client's position to the other party. Knowing these issues in advance prevents you from being in the embarrassing position of tentatively accepting some term, and in effect, agreeing to its reasonableness, with the caveat that you have to check with your client. Knowing your client's threshold eliminates the wasted time and effort involved in this process. Remember that most of these conditions are informed business decisions that you should know in advance are unacceptable to your client.

Other Licensee's Rights

One more obvious situation occurs when the client has already granted exclusive rights in a particular territory to another person or is granted nonexclusive rights to a party and the potential licensee is seeking exclusive rights.

Clear Purpose for Limits

If your client has set certain limits that are not negotiable, be sure that you understand the reason for your client's position. While it is easy to understand that no rights can be granted in a territory where another licensee already has exclusive rights, many other limitations may not be so easily understood. Also, your client's licensing program may include future plans or projects which are still confidential and cannot be disclosed to the other party during your negotiations. For example, if your client has already developed an improved version of the technology and is in discussion with another entity with respect to an exclusive license of the improved version, you will have to craft a term that will limit the present licensee's right to make the improved version.

Outer Limits

By this section, I merely want to reiterate the fact that you must keep in mind the goals of the licensing program when drafting the agreement. It may be possible with a substantial amount of creativity to draft specific terms to overcome the type of deal breaker obstacles we have been talking about., It may even be possible to modify the program goals slightly if the potential licensee can provide sufficient advantages to the program. However, the sooner both parties understand the "outer limits" or the nonnegotiable issues, the greater the chances are that the license can be consummated.

Warranties

A brief note about potential warranties that can often cause negotiations to grind to a halt: We have written before about limitations on liabilities, indemnification, and the enforcement and defense of intellectual property rights being licensed. All of these terms may be potential deal breakers, particularly if they have not been discussed between the parties during any of their prior negotiations. Often a licensor or licensee may move forward merely on the assumption that typical fair and reasonable terms with respect to these issues are going to be part of the license agreement. Certainly, if your client intends to propose a term or condition that is in any way out of the ordinary, they should be explained to the other party before they are merely inserted into a draft of the license agreement.

TERMINATION: WHEN SOMETHING GOES WRONG

Obviously, one of the key issues in any license agreement relates to termination, when and how, and for what reasons, one of the parties has the right to terminate the agreement.

Default Trigger

The event that triggers the right of one of the parties to terminate the agreement must be clear and unambiguous. There may, for example, be several terms in an agreement that would give the licensor the right to terminate. In addition to having the necessary clarity, you must also provide the mechanism for giving notice to the other party.

Curing a Default

Often a particular term relating to termination can be inadvertently or accidentally breached by one of the parties so that it is typical to include in the agreement the right to cure the default within a certain defined period of time, such as 30 days, or the like. A similar notice mechanism is essential.

Winding Down

Another necessary term must take care of the winding down of the licensing arrangement. For example, a licensee may have inventory that is yet to be sold or delivered or pending orders for additional products. Certainly, if the licensor does not have a new licensee waiting to take over, it may make business sense to permit the current licensee to fill all outstanding orders or even continue with the license agreement until a substitute licensee is on board.

Arbitration

Many license agreements include an arbitration term that loosely fits under the ''when-something-goes-wrong'' subject. Arbitration can be much faster and less expensive than litigation, but it is almost never the ''cure-all'' solution. Also, in global agreements, it may be difficult to reach agreement as to where the arbitration should take place and how it is to be conducted and, as you might expect, as with the applicable choice of law, few licensees are keen on conducting the arbitration in any location other than their home jurisdiction.

Returning to the Status Quo

This term may be considered part of the winding up provisions in the case of termination. However, the intent is to put your client back in the same position, or a better position, than he would have been had the license not been terminated. Obviously, these terms can be very onerous and, therefore, a reasonable evenhanded approach, is preferable.

American licensees, and more particularly, their lawyers often propose terms that provide immediate or injunctive relief in a way that requires the licensee, in advance, to agree that monetary damages are not a sufficient remedy. These types of terms are particularly offensive to many political foreign licensees and, therefore, delicate handling is required.

CONCLUSION

Know The Deal

• **Understand the Program's Goals** — It's key that you talk to the business people so that you have a clear understanding of where they want to go with the licensing program. Don't assume that you automatically know what the client wants to do.

• **Business Focus** — Keep your eye on your client's business and its plans or reasons for granting the license. You may come up with ideas, for example, with respect to field-of-use limitations that your client may not have considered.

• **Contact Person** — Be sure you have direct access to one person that has the authority to make decisions. More than a few agreements have died because the negotiators could not get a timely answer to a specific question.

IDENTIFY LIMITS EARLY

• **Inform Other Party** — As explained above, make sure both parties know from the onset what provisions are nonnegotiable. Otherwise, you may be wasting a lot of time just to run into a brick wall down the road.

• **Precise and Clear Boundaries** — Make sure these points are clearly explained and understood by the other party, any ambiguities merely delay a final agreement.

• **Explain If Possible** — Although it will not always be possible, if there is a nonconfidential reason why your client has taken a specific position regarding a nonnegotiable term, it will be helpful to explain the reason to the other party.

PROPOSE REASONABLE TERMS

• **No Hidden Agendas** — Don't come to the bargaining table with an agenda to accomplish something other than working out the terms of a reasonable license agreement. If you're trying to do something else, you're probably just wasting everyone's time.

• **Do Your Homework** — It goes without saying that you should be prepared and informed about all the terms that might be necessary, particularly if your license is to cover a large number of countries or jurisdictions. Know their limitations, and if necessary, the procedures required if you re going to seek exemptions.

• **Stay Focused on Program Goals** — Make sure the terms that you propose fit within the client's licensing program and yet, at the same time, are generally considered to be reasonable.

GLOBAL CONSIDERATIONS

• **European Union** — Provide a mechanism for the parties to see if an exemption is necessary.

• **Statutory Protection** — Make sure your client has obtained the necessary statutory protection for the intellectual property rights that are the subject matter of the license agreement. Include terms in the agreement requiring the parties to seek or obtain additional protection if available and how the costs are to be shared.

• **Manufacturer's Loss of Control** — When proposing field-of-use restrictions, remember that it is not always possible for your licensee or the manufacturer of the end product to control where it is ultimately sold to the end user. This is particularly true of consumer goods and can become a substantially more complex issue if sublicensing rights are granted.

GOOD-FAITH DEALING

• **Credibility Issues** — It goes without saying that you will lose all credibility if you're not honest in your negotiations. Also, when dealing with a potential foreign licensee, you should take some time to learn the business and social customs in that particular country since they also will affect your credibility.

• **Explain Objectives** — Be clear in negotiations and give clear straightforward explanations with respect to your client's objectives in negotiating the license.

• **Close the Deal** — Ultimately, it is up to you to craft a document so that the licensing program can move forward. Be a facilitator and not a roadblock.