

Practical Considerations For Agreement

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Any provision to be considered in developing mutually satisfactory technical-assistance agreements

This paper sets out thoughts on matters to be considered in developing a technical-assistance licensing program or in entering into a single technical-assistance agreement. It is assumed there will be patentable assets included in the license; however, many of the comments will be applicable for agreements that do not include patentable assets.

Definitions

In my opinion, one of the most important sections of a technical-assistance agreement is the "Definitions" section, because it sets the stage for what is to be licensed, who gains the fruits from such license, the territory and the scope of the information, and patents to be licensed.

Licensor-Licensee

The parties to the license will normally be *do-it-out*; you simply have a licensee granting a license to a licensee. However, if the licensor is a large multinational corporation, you may have a situation in which the agreement originates with a division whose major product line is one of the "Licensed Products" but a different division of the company also produces articles similar to such Licensed Products as one of its minor lines of business simply to complement its major product line. The second division may be strongly opposed to any agreement that permits the licensee to learn about its operations or its market activity of products, even those that fall within the definition of "licensed products." Accordingly, it may be desirable in defining the licensee to

specifically exclude such division and to include in "licensed products" specific products manufactured only by such division. In order to be completely effective in excluding information from the second division from reaching the licensee, it is recommended that the licensee rely not only on such exclusion in the definition of the parties but that similar limitations and restrictions also be included in the definition of technical information and in those provisions of the agreement that affirmatively set out the obligations of the licensee in providing information to the licensee.

The problem of exclusion becomes exacerbated if the respondent division is the originator of a patent, the subject matter of which is being used both by it and by the primary division licensing the technology in the manufacture of licensed products. Since any such patent may be held in the name of the corporation, if it is to be excluded from the licensed patents, there must be a specific provision excluding such patent if the definition of licensed patents would otherwise be broad enough to include it.

In considering the question of improvements developed by the licensee under the technical-assistance agreement, consideration should be given whether parties other than the licensee should receive rights to such improvements. This is particularly significant where there is a grant back of rights to the licensor on a worldwide basis and the licensee has operations only in the United States, but has partially or wholly-owned affiliates or subsidiaries operating in other countries that could benefit from a licensee to such improvements. Accordingly, it may be desirable to have a separate definition of "licensee group" which would include

the licensee and certain affiliates, say those which are _____% or more owned by the licensee. Members of the licensee group (other than licensee) may not have an obligation to grant any license to the licensee but may receive the benefits of a license from the licensee on improvement inventions relating to technical information for their particular territories.

Licensed Products

In developing the definition of licensed products, the licensee needs to reach a decision as to which of its products it wishes to license. Thus, the licensee may determine that it wishes to grant licensee only to one specific product line or several lines of products. In making any such limitations, the licensee must evaluate the extent to which significant technical information relating to the manufacture of its other products will inherently be disclosed to the licensee of the single product line. This becomes significant if the royalties are based only upon the licensee's manufacture and sale of licensed products. Thus, the more restrictive the definition of licensed products, the smaller the potential royalty base.

Even in those technical-assistance agreements in which the licensed products are defined to include broad categories of products, there may be certain products that the licensee will want to have specifically excluded either because it wishes to market these products itself in the licensed territory or because it is subject to some restrictions as a result of an agreement between it and a third party. In the latter case, one obviously needs to be taken in

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drafting any agreement to make certain the licensor is not committed to license more than it is lawfully entitled to do.

Technical Information

Preferably, this section will broadly define technical information to include all information relating to licensed products including product designs, production equipment and processes, inspection equipment, plant layouts, specifications, drawings, training and operational manuals, models and, possibly, access to associated computer systems subject to certain specific limitations. It may be desirable to specifically exclude design and analytical computer programs and source codes and to provide that any computer systems must be utilized at the facilities of the licensee under the supervision of the licensor's personnel. Additionally, even though the licensee may have developed production equipment and/or inspection equipment used in the manufacture of licensed products, the licensee may not wish to give the licensee detailed drawings of the machines or inspection equipment or give the licensee the right to manufacture such equipment. In that event, care must be taken to insure that the definition of technical information is not so broad as to obligate the licensee to provide detailed drawings of such equipment.

It is recommended that the technical information be specifically limited to that information which is "utilized commercially by licensee." This prevents the licensee from having access to research and development relating to licensed products until such research and development efforts are incorporated in licensee's commercial operations. Since the licensee is undoubtedly looking for the most current technology of the licensor throughout the term of the agreement, it will seek to have included not only technology owned at the time of execution of the agreement but also that acquired by licensee during the term of the agreement; however, licensees usually are agreeable to the "utilized commercially-by-licensee" limitation.

Licensed Patents

If the licensed products are for a wide range of products manufactured and sold by the licensee, the definition of licensed patents will be fairly broad and may include all patents of the licensor pertaining to licensed products. The licensee will undoubtedly seek to have included as licensed patents not only patents and patent applications owned at the time of execution of the agreement, but also those acquired by the licensor during the term of the agreement. Additionally, in order to restrict licensed patents to those that have been used commercially by the licensee, the definition of licensed patents should be limited to those "... based on any form of technical information." As previously noted, the definition of technical information is limited to that information that has been used commercially by the licensee.

Even in those instances where the technical assistance agreement is directed to a single specific product, the licensee will desire to have the patent grant broader than a simple listing of specifically identified patents and will undoubtedly request at a minimum to have included in such definition any "... patents on improvement inventions acquired by the licensee that cannot be utilized without infringing..." the specifically identified patents.

Licensor's Territory

While this is fairly self explanatory, it should be noted that a licensee should not assume that the licensed products manufactured by the licensee will never be sold outside of the licensed territory. Thus, many agreements license the licensee to manufacture licensed products only in the licensed territory but to sell anywhere in the world with a stipulation that no licensee are granted unless any patent in any country other than the licensed territory. Even if a licensee were to attempt to restrict the licensee's sales to the licensed territory, there could be no restriction on a distributor or other purchaser who purchased such licensed products in the licensed territory from selling the licensed products in any other country where no patent existed on such li-

censed products. Additionally, if the licensed products were manufactured in a country of the European Economic Community and a royalty paid based upon such manufacture, a licensee would, under the EEC regulations, have the right to sell in any other country of the EEC, even countries where licensee holds patents on such licensed products.

Trade Secret

All technical information is normally the subject of a confidentiality obligation, which is imposed upon licensee during the term of the agreement and for a fixed period of time, say five years, after the term. However, certain types of technical information give rise to a higher level of confidentiality. These are "trade secrets" and are defined in the Uniform Trade Secrets Act as follows:

- (1) "Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that
- (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
- (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

Net Sales Price

Many license agreements provide a definition of net sales price as a basis for establishing a royalty based upon a percentage of the net sales price of all licensed products sold or otherwise disposed of by the licensee. Obviously, there are many other bases which can be used for establishing the royalty to be paid, including those based upon a fixed amount for all licensed products produced or sold or a fixed amount per unit quantity of fixed

material processed into licensed products. However, structuring a royalty based upon net sales price has an advantage of having a built-in inflation factor in that, as the price of the licensed products rises, so does the amount of royalty per unit sold even though the royalty rate stays the same.

Substantive provisions

With a sound basis provided by clear definitions, the licensee and licensor are ready to proceed with substantive obligations of the parties. Obviously, these will include a clear understanding of the precise obligations of the licensor in furnishing technical information, limitations on use which the licensee may place upon such technical information, confidentiality obligations resulting from the disclosure of technical information, the license grant both for licensed patents and for technical information, whether such grant is exclusive or non-exclusive, applicable royalties including minimum annual royalties, grant-back and improvements and others.

Furnishing of information

The technical assistance agreement should set forth with clarity the obligations of the licensor in providing technical information to the licensee. For example, it may be desirable that a provision be included stating that the obligations of the licensor to provide material in written form be limited to that previously prepared by the licensor for general distribution in its own operations. If it is intended that the licensee is to perform design work or other technical process requiring significant technical effort, the agreement should specifically so state and a separate fee provided, possibly on a per-diem-plus-expense basis. Additionally, the licensee may wish to limit its obligations to provide such services to the extent it has manpower readily available.

The nature of personnel of the licensee in facilities of the licensee will frequently be at no charge except for the royalties as set forth in the payment section to be discussed below. Accordingly, it is desirable to place some limit on the licensor's obligations; for example,

"...no more than _____ man-days per year..." of services to be required of the licensee under that specific paragraph. Additionally, the licensee will frequently wish to have competent personnel of the licensor visit facilities of the licensee in order to, among other things, provide training to the licensee's personnel and assist in solving specific problems in the manufacture of licensed products. This may be done on a per-diem-plus-expense basis and will generally include a minimum yearly obligation of "...no more than _____ persons and no more than _____ weeks at a time ..." and "...no more than _____ man-days in any calendar year."

Limitations on Use/Conditions of Commerce

It is important to clearly specify precisely what use can be made of the technical information to be provided. Thus, while it should be clearly stated that the technical information is "...only for licensee's use..." the parties should further agree on whether there are any limitations on licensee's use of such technical information. Frequently, technical assistance agreements will provide that technical information may be used only for the production of the licensed products. However, there are occasions when a licensor may permit a licensee to use such technical information in the manufacture of other of its products. If the licensee is permitted to use technical information in its manufacture of such other products, the parties will need to determine whether any royalty is to be paid based upon the licensee's use of technical information in its manufacture of products other than the licensed products. If this is done, it is recommended that a second category of supplemental products be clearly defined at the time of entering into the agreement. The definition of supplemental products would be broader than the licensed products and would include all products which conceivably could benefit the licensee using the technical information. It is likely that the royalties on these supplemental products would carry a lower royalty rate because the licensor would have no obligation to actively provide infor-

mation or grant licenses under patents specifically directed to such supplemental products.

Additionally, the parties need to determine the rights, if any, of licensee to continue to use technical information following expiration of the agreement. If the licensee is willing to permit the licensee to continue to use technical information following expiration of the agreement, considerations might be given to a provision under which the licensor's obligation to disclose newly developed and commercialized technical information terminates a period of time, say two or three years, before expiration of the agreement. This will prevent the licensee being obligated to disclose details of a significant development that licensee introduces into commercial use in the last few months of the agreement. In the absence of such provision, the licensor would be faced with the possibility of receiving no significant royalty income directly related to any such development unless there were patents relating to such development. Thus, this will provide at least a minimum defined period of time during which the licensee will receive royalties on its newly commercialized unpatented developments. From the licensor's standpoint, such provision could also have the advantage of inducing the licensee to renew or extend the agreement in order to acquire a license to such new commercial developments.

Additionally, consideration should be given as to the rights of the parties in the event the agreement is terminated prior to the normal term. Such early termination could result from default of one of the parties, the failure of licensee to meet some predetermined minimum level of production or results, bankruptcy of one of the parties or any other reason in the agreement permitting early termination. For example, in the event the licensor has a claim for involving such early termination, the agreement would probably require that licensee return to licensor any confidential information that constituted technical information. The licensor would obviously like to have initiated a provision under which the licensor alternatively agreed to cease production and sale of licensed prod-

sets in the event of any such early termination of the agreement.

While this might be acceptable to a licensee if the licensed products were for a very narrow category of products that the licensee had never produced prior to the agreement, it obviously would not be acceptable to a licensee if the licensed products were for a broad category of goods which the licensee had produced prior to the agreement. In that event, the most the licensee might be able to negotiate with respect to unpatented information would be a commitment from the licensee to stop using technical information.

The licensee to use licensed patents will normally expect upon expiration or termination of the agreement. The parties may wish to include a provision obligating the licensee to grant a license under any licensed patent upon request of licensee made prior to expiration of the agreement. Although such provision could set the royalty for any such license, it is more likely that the agreement will provide that the royalty is to be reasonable and will be negotiated but subject to binding arbitration in the event a negotiated royalty cannot be agreed upon. This provision should not be available to a licensee whose agreement has been terminated by a licensor.

With respect to confidentiality, as previously noted, the obligation to retain technical information in confidence will normally run during the term of the agreement and for a fixed period of time following the agreement, however, such obligation will normally include any information that was previously known to the licensee as evidenced by its prior written records, any information disclosed to a licensee by any third party having a lawful right to make such disclosure and any information that becomes freely available to the public through no fault of the licensee. In contrast, the confidentiality obligation of the licensee with respect to trade secrets may continue indefinitely or until the occurrence of one of the above exclusions.

License Grant

It is suggested that consideration

be given to having a separate license grant for technical information and the licensed patents. This is particularly true when the licensee desires an exclusive license under the technical information but is willing to accept a nonexclusive license under the licensed patents. The licensee will frequently prefer that the license granted under the licensed patents be nonexclusive because it may provide maximum flexibility in dealing with any third-party infringers of such licensed patents. The licensee under the technical information will want to use such technical information in the licensed territory for the manufacture of licensed products and to sell such licensed products throughout the world. The license under the licensed patents may be to make, use and sell (and possibly "to have made") the licensed products in the licensed territory and to sell such licensed products throughout the world subject to a proviso that "... however, no license is granted under any patent of license in any country other than the licensed territory." Thus, the licensee will have the ability to sell its products wherever it wishes but does so at its peril if it sells in a country outside the licensed territory where licensee has a patent covering such licensed product. Note the exception with respect to the European Economic Community discussed under the definition of "Licensed Territory."

As pointed out in the section on definition of "Technical Information," even though the licensee has proprietary equipment that it uses to manufacture licensed products, it may well not grant to the licensee the right to manufacture such equipment. Thus, since the primary objective of the agreement is for the manufacture and sale of licensed products, the agreement may simply provide that the licensee will sell or otherwise make available to licensee any such equipment and that the license with respect to such equipment is simply a "use" license.

Even though the licensee grant with respect to technical information may be exclusive, the licensee may wish to include a reservation

of right permitting it or a majority-owned subsidiary to use such technical information in the licensed territory.

As noted in the section entitled "Limitations on Use/Conditions of Confidence," it should be recognized that the technical information may be usable in making a number of products other than the licensed products. Inspection of what agreement is reached regarding the extent to which the licensee is permitted to use the technical information, if the licensee to use technical information in exclusive territory in drafting must be taken to make certain that the licensee has not inadvertently precluded itself from providing technical information to third parties in the licensed territory for use in manufacturing products other than licensed products.

Royalties

Royalties may include the following:

1. A *disclosure fee*, a portion or all of which may be credited against running royalties for a specified time period.
2. *Minimum annual royalties* including either a firm obligation to pay the difference, if any, between the minimum annual royalty and the actual royalties accrued and paid for a specific calendar year or a covenant of the licensee then exclusive to nonexclusive in the event the running royalties do not meet such minimum annual royalty and the licensee fails to pay the difference.

3. *Sliding royalties*. These can be based upon a percentage of the net sales price of all licensed products sold or otherwise disposed of or upon one of a variety of other measures including: — Dollars per pound of raw materials used in the manufacture of the licensed products. — Dollars per unit quantity of the licensed products produced, etc. Note, however, that if a fixed measure is used, it may be desirable to include an inflation factor that adjusts such fixed factor based upon changes in the Consumer Price Index, Producer Price Index or some other readily ascertainable measurement.

Grant, Use and Improvement

It is desirable to include a specific provision clearly setting forth what rights, if any, the licensee receives under any technology developed by licensee in its use of technical information and any improvement patents developed or acquired by the licensee, the countries in which the licensee will exercise any such rights and who other than the licensee may share in any such license. For example, the licensee itself may not operate in any country other than the United States but may have a number of majority-owned subsidiaries or other affiliates located in countries other than the United States or the licensed territory, which it wishes to be able to use improvement technology and improvement patents developed by the licensee.

Disclaimer of Warranty

From the licensor's standpoint, it is desirable to include a provision that the licensee makes no warranty that the licensee's use of the technical information and licensed pa-

tents will not infringe patents owned by any third party and that it makes no warranty as to the validity of any of the licensed patents. There could, however, be a provision adjusting the royalty in the event a key licensed patent were found to be invalid. Accordingly, it may be desirable to set both separate royalties for technical information and licensed patents. Additionally, the licensee will desirably wish to have included a provision setting forth that the licensee is responsible for determining the adequacy of its products for their intended use and indemnifying licensee in the event of injuries to third parties from the use of the licensed products manufactured by the licensee. The licensee will wish to have some adjustment to its royalties in the event one of the licensed products is held to infringe an adversely held patent.

Termination

As pointed out above, the parties should recognize that the agree-

ment may expire upon completion of the term and the fulfillment by the licensee of all of its obligations or could be terminated early for one or a number of reasons. Accordingly, the agreement should clearly set forth the rights of the parties upon termination in any of the foregoing circumstances.

Conclusion

The license agreement will, of course, include many other provisions that will be determined by the specific commercial needs of the parties and the types of products to be licensed. Hopefully, the foregoing will give food for thought to licensors and licensees in developing mutually satisfactory agreements. The most satisfactory agreements will obviously be those that permit a licensee to develop a solid market for the licensed products in licensed territory and permit the licensee to benefit from its development efforts by receiving satisfactory royalty income and rights in improvements developed by the licensee.