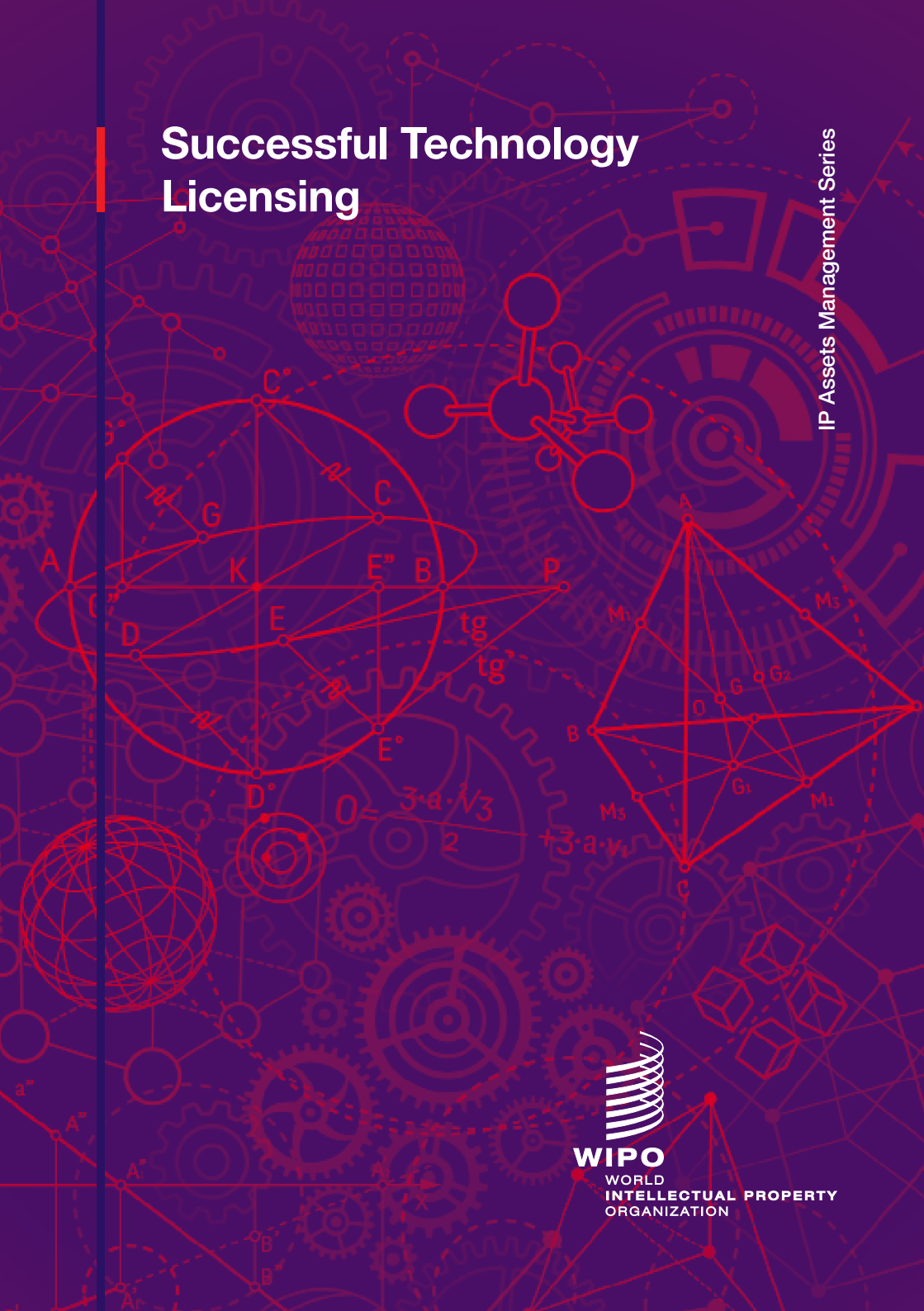
# Successful Technology Licensing

IP Assets Management Series



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IP Assets Management Series


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# Preface

Intellectual Property (IP) licensing is a frequently used means of exploitation of IP, including in the process of commercialization of research results generated in universities and publically funded research institutions.

In today's knowledge-based economies, the prevailing model of IP collaboration among academic and business organizations is "open innovation", based on licensing deals among various participating partners. Therefore, there is a growing interest on the part of innovation stakeholders in the World Intellectual Property Organization (WIPO) Member States in acquiring more practical knowledge about licensing as a useful tool for transfer of knowledge and IP.

This Successful Technology Licensing (STL) Manual was developed as a response to requests for a user-friendly manual aimed primarily at an audience of businesspersons, technology managers and scientists who are dealing with licensing in the course of their work. Licensing occurs in the context of various business and collaboration relations, such as mergers and acquisitions, joint ventures, research collaboration agreements, joint research and development arrangements, etc.

This Manual focuses on issues essential for understanding licensing, including:

- the context in which licensing may occur;
- key terms of a licensing agreement and negotiation methods; and
- how to prepare for and negotiate a win-win licensing contract.

It is evolving material that can and should be reviewed and improved in line with users' needs.

In the framework of the Development Agenda (DA) process – in particular, DA Recommendations 7, 23 and 32 – WIPO Member States have requested more information regarding (a) the interface between Intellectual Property Rights (IPRs) and competition policies, (b) how to better promote pro-competitive intellectual property licensing practices and (c) information on the links between IPRs and competition policies. In response to this request, WIPO has prepared this new, second edition of the STL Manual, with a new Cluster V on "Understanding Certain Anticompetitive Concerns Related to Technology Licensing", followed by concrete examples of pro-competitive licensing practices in the Annex II.

I wish to extend my appreciation to all who provided guidance and comments in the drafting of this work, in particular to Mr. Patrick O' Reilley, who edited the text and provided very valuable contributions to this booklet on behalf of the Licensing Executives Society International (LESI).

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# Introduction

This text focuses on licensing as a means of exploiting intellectual property (IP). Before examining the licensing process it is important to consider the context in which licensing may occur. IP, as an asset to a business, may be exploited in many ways. A business may acquire IP for defensive purposes – using the IP to prevent copying of the businesses products or service or to assert in response to an IP challenge from another party. IP may also be used offensively – aggressively asserting it to frustrate competitors, obtain market share, control geographic markets, or generate revenue. Many businesses use their IP assets as leverage in negotiations for business deals, such as, for example, joint research and development arrangements, acquisitions or mergers, or strategic collaborations. Sophisticated businesses use IP for many different business purposes; basic licensing as discussed in this text is only one way to exploit IP.

The basic principles of licensing, as explained in this text, apply to most of the more complex methods of exploiting IP. A significant part of strategic collaboration, for example, is cross licensing of the parties' IP so that each party can cooperatively develop, manufacture and market products for their mutual benefit. Even aggressive assertions of IP against competitors, in most cases, end with a settlement in which the IP is licensed to the competitors. Learning the basics of licensing is a prerequisite to undertaking any of the more complex means for exploiting IP.

An introduction to successful technology licensing may be summarized by six fundamental and simple ideas.

**First: Technology licensing only occurs when one of the parties owns valuable intangible assets, known as Intellectual Property (IP)**, and because of that ownership has the legal right to prevent the other party from using it. A license is a consent by the owner to the use of IP in exchange for money or something else of value. Technology licensing does not occur when there is no IP.

However, IP is a broad concept and includes many different intangibles (e.g. patents (inventions), copyright (works of authorship including technical manuals, software, specifications, formulae, schematics, and documentation, among other things), know-how (e.g. expertise, skilled craftsmanship, training capability, understanding of how something works), trade secrets (a protected formula or method, undisclosed customer or technical information, algorithms, etc.), trademarks (logos, distinctive names for products and services), industrial designs (the unique way a product looks such as a computer's molding), and semiconductor mask works (the physical design of semiconductor circuits).

**Second: There are different kinds of technology licenses.** You will hear licenses referred to by many names, but it is useful to think of them in three categories. Licenses may be for certain IP rights only (e.g. a license to practice an identified patent or to copy and distribute a certain work of authorship). Licenses may be for *all the IP rights of any kind* that are necessary to reproduce, make, use, market, and sell products based on a type of technology (e.g. a license to develop a

new software product that is protected by patent, copyright, trademark and trade secret law).

A license may also be for all the IP rights necessary in order to create and market a product that complies with a technical standard or specification (e.g., a group of enterprises has agreed on a technical standard to ensure interoperability of devices and owners of IP essential to practice the standard pool their IP rights and license to anyone who wishes to use the standard on reasonable and nondiscriminatory terms).

**Third: Technology licensing occurs in the context of a business relationship in which other agreements are often important.** These agreements are interrelated, whether they are in distinct documents or integrated in one big document. It is important to consider in a very practical way how the terms of these related agreements affect each other because of timing, pricing, and overall value. So, for example, to avoid future business disputes an agreement to develop a product (R&D agreement) should also address who has rights under pre-existing and newly created IP rights (IP license), who will have a licence to manufacture the product (manufacturing agreement),and, where appropriate, at what price one party will sell the product to the other party (sales agreement).

**Fourth: Technology licensing negotiations, like all negotiations, have sides (parties) whose interests are different, but must coincide in some ways.** Successful technology licensing occurs only when the negotiator understands thoroughly the benefits that are available to both parties.

It is difficult to successfully negotiate a license where you wish to obtain the rights to technology if you have little to offer in return. Ideally, both sides to the negotiation will have different elements of value to offer, including, for example, skilled employees, a market that can be commercially exploited, know-how, research facilities and commitments, and some form of IP.

Unlike sales transactions involving physical property, IP licenses generally involve more than the simple question: “how much?” The goal is to find a good balance of value so that the license is a “win-win” transaction.

**Fifth: Technology licensing involves reaching agreement on a complex set of terms**, each of which has several possible solutions. Therefore, advance preparation is essential. In advance of the negotiation, before the other party has been approached, a party may spend many months defining business objectives, assessing leverage, researching the other party, deciding positions on key terms, preparing documentation, and protecting IP, among other tasks.

**Sixth: Technology licensing is not necessarily synonymous with technology transfer.** The fact that two parties reach a deal on licensing does not mean that the subject matter of the deal is actually transferred. Because technology licensing concerns not only knowledge that is

expressed in writing, but also knowledge in the form of practical know-how or trade secrets (generally kept secret). It becomes an actual transfer when the licensor delivers the technology and knowledge to the licensee and the licensee learns how to effectively use, adapt and where possible improve the technology and knowledge. Ensuring the occurrence of knowledge transfer should be one of the major concerns of negotiators, in particular the licensees. Only when that occurs, an effective technology transfer takes place.

# II. Preparation for Negotiation

Preparation for technology licensing negotiation begins with the parties asking themselves a series of questions. These questions must be answered whether the party is the licensor (the one who owns the IP and gives the license) or the licensee (the one who wants to use the IP and wishes to receive the license). Each party should ask itself the questions not only with respect to its own position, but also with respect to the probable position of the other party; each party will be in a better position for negotiations if it attempts to understand the other party's position. It is essential to ask and answer these questions *before beginning* technology licensing negotiations.

## A. What is the business reason for this license?

How will this license agreement make money for each party?

What must each party gain in order for this agreement to be worthwhile?

What is the best result that can be obtained for each party?

What outcome does each party want to avoid?

From a business perspective, is the best result for a party a license to IP rights only (pure IP license) or a broader set of related agreements (business partnership)?

Ideally, what does each party want to obtain or provide:

- Assistance in using the IP (know-how)?
- Training?
- Development of technology or a product?
- Manufacturing rights or capabilities?
- A supply of products or equipment for sale or purchase?
- Multiple products?
- Investment in R&D or the party?
- Distribution of products or technologies?
- A license (consent) to use a patent or copyrighted material or trade secret (or other IP) that belongs to the other party?
- A license to use a trademark or logo?
- A license that will enable you to comply with a technical standard or specification?

Each party must consider the license from the perspective of one receiving rights (license in), or giving rights (license out), or both receiving and giving rights (cross license)?

If this is a license in, will the licensee pay money to the licensor? If this is a license out, will licensor receive money from the licensee? Will there be money paid or received in a cross license? Is payment of money the primary benefit/value that will be provided in exchange for the license or are there other benefits/values?

## B. What leverage does each party have?

Why does each party want or need this agreement? What leverage does each party have that will make it more likely than not that the other party will agree to terms?

A party may have leverage if it is willing to give the other party favorable terms or below market terms, but generally leverage is some pressure or advantage outside the terms of the potential agreement.

- Need for money or investment.
- Need for new product to be competitive.
- Threat of litigation.
- Need to resolve dispute for customer.
- Required to license because of standard setting obligation or to avoid competition law violation.
- Need for technology from the other party.

Does either party have an alternative? Could a party negotiate more than one alternative deal at the same time?

## C. What is the time frame for signing the license agreement?

Must it be completed in time for:
- A product launch?
- A press release?
- A trade show or conference?
- Beginning a research project?
- Commencement of manufacturing or sale?
- An investment or acquisition/sale transaction?

Because use of IP in a development program can be infringement, it is risky to begin to work on a technology project before a definitive agreement has been reached. Negotiating and signing a license agreement is an important step.

Is it possible to reach agreement on all the issues *at this time*? Or, will unknown facts prevent reaching a definitive agreement?

Can the transaction be broken down into stages (e.g. interim agreement and then final agreement, or multiple successive agreements) without harming any party?

What is a realistic schedule for negotiation meetings, drafting, and execution of the agreement?

## D. What data and documents do you or the other party need?

What specifications, protocols, public information, product sheets, and patent abstracts and texts, and all other information are relevant to the technology? Put them in notebooks organized so that they are easy to refer to, and if voluminous, index them.

What information related to the business of the other party do I need (e.g. public information on revenues, employees, financial history, technology press releases, website information, etc.)? Put this information in a notebook, too.

What information do I have related to alternative parties?

What other agreements am I aware of that may be similar to this agreement? Gather samples and forms of agreements that seem relevant to this transaction.

## E. Who is on the negotiating team?

Decide who will participate in the negotiation representing your side (the team).

Who will be the principal spokesperson? Who will be present in the negotiation, but in a supporting or secondary role?

Who will have authority to decide issues that arise?

Who will need to be consulted about practical issues that arise (e.g. how much money can be spent, what commitments can be made to technical service, what technical requirements there are, etc.)?

Who will be the legal counsel?

Who will be responsible for drafting the agreement or responding to drafts and changes from the other side?

## F. What are your positions on the key issues of the license?

The key issues (or terms) are the important business and legal terms of the license. The key issues for a technology license are discussed in the next Section (III). The best way to work through and decide your position on the key issues is to use a term sheet.

A term sheet is a *short* outline (no more than two pages) of the key terms of the license, concentrating on the "business terms". It has an internal version and an external version. The internal version is for your use only and the use of your team. The external version is a version of the term sheet that will be given to the other party in the negotiation as an aid to reaching agreement.

A term sheet is not the same as a Letter of Intent or a Memorandum of Understanding (See Section H. below; these are not recommended). A term sheet is *not* a short agreement. It is a list of the key terms with a tentative statement of your position written under each key term. It has many important functions. Because the laws of some countries may make the external version of a term sheet (the one given to the other party) enforceable in the event negotiations fail, every term sheet should be marked with a legend that disclaims any agreement or any obligation to negotiate and that states only a definitive agreement signed by both parties will be enforceable. At a minimum, applicable laws may require the parties to a term sheet to negotiate in good faith. Because the effect of a term sheet varies depending on applicable law, every term sheet involving parties from different countries should include a choice of law.

The most important work of a term sheet is to help sort through the many complex issues in a technology license and make sure that you don't miss any. It helps spot problems (e.g. you realize that you are not sure whether you need the right to modify the technology and you believe that the other party has a strong policy against granting a right to modify). It also helps communicate within the team so that consistent positions are taken, avoiding the embarrassing experience of having different

team members say different things in the negotiation session. If legal counsel is not present in the negotiation, the term sheet is an invaluable tool in communicating with him or her. It is used to make sure that the positions that you plan to take are in fact authorized and practically feasible (e.g. you find out that you planned to agree to provide service and support, but you find out that your enterprise does not have enough personnel). Finally, it helps the team keep track of the objectives of the negotiation.

Use a form term sheet, such as the one in the *Appendix* to this booklet, and go through each issue. Decide what you think that your position should be on each key term based on your business objectives with this technology license. You will want to think of fallback positions and whether it will be possible to compromise on each key term. Write all of this down on the term sheet using plain, non-legal language.

Circulate the term sheet *internally* (within your party only) on a confidential basis to persons who must be consulted to obtain internal clearance and obtain reactions, suggestions, approval. Show it to the legal counsel and obtain his or her edits and comments.

## G. What is your negotiating strategy?

Confer with the team about the answers to the following questions.

For each term in the term sheet, what is your "first line"? This refers to the set of terms that are first set forth in the negotiation and represents an aggressive or ideal position. This is written in the external term sheet.

For each term in the term sheet, what is your "bottom line"? This refers to the set of terms that, from your side's perspective, must be agreed or the objectives of the agreement will not be achieved. The bottom line is not disclosed until late in the negotiation, if ever. This is not written in the internal term sheet because of the importance of confidentiality of these terms. The bottom line should not change dramatically in the course of negotiations.

What are the other party's first line and bottom line likely to be?

Use your internal term sheet throughout as a guide to the negotiation and as a communication tool for your negotiating team.

What are the alternatives if your bottom line cannot be gained?

## H. Will you need preliminary agreements?

**Confidentiality agreements** (non-disclosure agreements) are often important to protect business and technical disclosures that are made during the negotiations. Indeed, where the technology under consideration is proprietary, the potential licensee may wish to evaluate the technology in advance of negotiation; such evaluation may be performed under a limited confidentiality agreement.

**Interim agreements, feasibility agreements and prototype agreements.** These are sometimes useful when you

need more information in order to know whether a technology license would be a good idea. The key terms in such agreements are generally that each side will bear its own expenses, or that one side or the other will pay certain expenses or provide equipment or data, who will own any IP used or created, who will do what work, prototype creation, or testing, confidentiality (see above) and that the agreement will end by a certain date (usually very short term-weeks or months). Such short-term agreements should not be used as substitutes for the technology license or other agreements.

**Do *not* use Letters of Intent or Memoranda of Understanding.** These are not agreements, but are often vague statements of intentions and plans for the future. These are not useful because they are insufficiently concrete for business objectives, and cause confusion as to whether they are legally binding.

Standstill agreements or agreements to negotiate on an exclusive basis are almost never desirable and should generally be refused. They can give an undue advantage to one side in a negotiation and remove the option of turning to an alternative if negotiation is not successful.

## I. What are the strong points and objectives of the other team?

What are the strengths of the other side's negotiating representatives? Do the representatives who are communicating with you have authority to make decisions?

What are likely to be the other side's positions on each key term?

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**Meet with the team to discuss and answer the questions set forth in this Section and in Section III below before the first meeting with the other party. This communication avoids misunderstanding about the basic objectives and terms of the license, and is an important component in technology licensing.**

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# III. Key Terms

The issues that are agreed upon in a license agreement are called the "terms" (or "material terms" or "terms and conditions" or "provisions"). What makes technology licensing complex is that there are more key issues in such agreements than in most other types of agreements. Also, for each key issue, there are many possible variations for how the issue can be resolved. The successful negotiator keeps a mental and written checklist of these key terms and the several variations on each that will be acceptable to him. He also knows what variations on each key term are disadvantageous or risky.

Although the key terms vary somewhat depending on what sort of technology is being licensed (e.g. computer software, a semi-conductor invention, a pharmaceutical formula, etc.), similar issues arise in all transactions in which a technology containing intellectual property rights is being licensed. The purpose of this section is to give you an overview of these key terms.[1] Note well that this is not an exhaustive list of material terms but rather an introduction to some of the issues that frequently arise.

To simplify, the key terms are grouped into **four "clusters"**. It is useful to think of the key terms in this way, and then to mentally break them down into smaller headings within each cluster.[2]

1 Note that this document is not intended as a substitute for legal advice. It is essential in any technology licensing negotiation to retain legal counsel. This list will familiarize you with the issues so that you can communicate effectively with your legal counsel.

2 From now on in this Section, it will be assumed that the negotiation involves a license In, but except where indicated the same comments apply conversely to a license out.

## CLUSTER ONE: THE SUBJECT OF THE LICENSE

### 1.1 What is the subject matter of this license?

This cluster of issues relates to the definition of the technology that is being licensed. This may sound obvious, but it is an underestimated issue that can give rise to disputes after the agreement has been signed.

Is the technology that you want to use a product, a formula, a specification, a protocol, a software program, a set of diagrams or documentation? If so, it is essential to describe this precisely. Or do you need a license to practice a specified patent or set of patents? Or is the subject matter of the license all the IP and technology required in order to meet a specified standard (standards licensing)?

The licensor's interest is in narrowing the definition of what is being licensed. The licensee's interest is in having a broad definition of the technology, although the licensee must consider the basis for payments under the agreement that often is coextensive with the scope of the license. In some cases, both sides will seek refuge in ambiguity about the technology for a number of reasons. In some cases, negotiators have not communicated well with other segments of their business and are either not sure what state the technology is, or are not clear to what use the technology will be put.

Sometimes, the lack of clarity in an agreement about what is licensed is because people do not want to admit that they do not understand exactly how technology works; they think that they should know. However, it is often not possible to learn about the exact nature of technology based on public records. **Part of the negotiation is finding out exactly what the technology is and what part of it you need to use for your business** (see Issue 1.4 below).

You may save money if you only license what you need in order to make your business use of the technology successful.

It is important to **communicate with your business colleagues** to see what they need in order to make effective business and technological use of the technology. Do they need only a patent license? Or do they need the rights to use a particular product or technology that practices the patent? Do they need detailed documentation or schematics? Do they need source code or is object code sufficient? What version of the software will they need? Do they require test data? Do they require samples or prototypes? (See Cluster 4, Issue 4.1 below). Will they need "know-how", or training in order to use the technology? (See Cluster 4, Issue 4.3 below).

**Beware of licensing technology for which there is no clear written specification or other documentation.** Do not accept vague references to the subject matter such as "the state of the art XXX technology". It is common to refer to an exhibit attached to the agreement text for more specific references to the nature and definition of the subject matter (e.g. The so and so technology, as more fully described in Exhibit A). Make sure that Exhibit A is filled in and what is written is clear and specific enough. Also, do not wait until late in the negotiations to obtain this information. If Exhibit A refers to a specification or some other written document, read it carefully to see if it clearly describes what is being licensed. The description should be clear enough so that, in case of a dispute, a third party who is not knowledgeable about the technology could make a decision about what is included and what is not. References to "version A" of the software may be sufficiently clear if you have a copy of version A and have already inspected it or a copy is deposited in escrow for your benefit. In some cases, you will be able to attach the actual thing that is being licensed to the agreement (e.g. a copy of the software).

## 1.2 Is the thing that is being licensed completed?

Is the software completely written, the hardware design completed and implemented in the form in which you need it, is customization required to make the subject work with your technology or systems, is a "port" needed, is research and development continuing? The same questions apply in other fields: is the technique completely developed, is the invention fully enabled, and is the pharmaceutical process fully developed?

If there is more work to be done, determine whether the completion of this work is important to you as a condition of the

deal. Can you live with the technology in an incomplete form (e.g. partially written software, incomplete formulation or test of a drug)? If it is left incomplete, will the agreement permit you or your designee to complete and/or modify the technology? See Cluster 2 below which discusses what the licensee is permitted to do to the technology.

Conversely, if you are the one licensing out the technology, make sure that it is clear whether you are expected to have fully completed it by the time of execution of the agreement. Does it have to pass acceptance testing? Does it have to meet a specification or a functionality test? Does it have to perform certain functions at specified performance levels in order for you to be paid?

**The best position for the person who is licensing technology out is that the software or other technology need not live up to any particular standard** of performance or function. In this case, the technology licensor is providing some basic rights to the technology, but is really providing his or her time and effort and a permission to use the technology *as is*. This is obviously not good for the person who is licensing the software, unless the price (royalties) and other terms reflect this. **The best position for the person licensing the software in is that the software must meet clearly defined specifications** (if it is not completed and accepted at the time of execution).

Avoid using terms like "meets commercial expectations" or "satisfies industry standards" or "use best efforts" or "makes good faith efforts" or "fully operational". These terms are so vague that they cause business misunderstandings and legal disputes. For example, in some countries the term "best efforts" is construed to mean what is reasonable under the circumstances, while in other countries the same term is construed to require doing everything that is possible. Instead of using a phrase having vague and variable meanings, define in the agreement exactly what steps would satisfy the intended "best efforts."

If the subject matter of the license is truly in a state of development, or if major work needs to be done, such as a port to a different platform, it is advisable to have a **separate or attached development agreement** with clear deliverables, assignments of responsibility, performance and function standards, and timetables.

## 1.3 Who owns the IP that underlies the technology?

Does the licensor own what he or she is licensing to you? Does he or she have the right to license it? Does he or she have the right to license all other technologies that are needed to make the licensed technology work?

It is important for the license agreement to contain a **representation that the licensed IP belongs to the licensor.** This avoids a situation where a third party later claims that it owns the IP or technology and the licensor attempts to disclaim responsibility.

In situations where the licensor and licensee will be working together on a

technology project or product creation (e.g. a joint venture to develop a product together), it is good practice to **specify in the agreement who owns what IP and/or technologies** as of the time of the execution of the agreement. If the licensee is contributing some technology or will be using some technology, it is also important to specify who owns that technology, so that there will be no later disputes.

In joint venture situations, the agreement will also define who will own any technology and IP that results from the project. This may be joint ownership, or licensor-owned or licensee-owned. Joint ownership means different things in different national laws, so be careful of settling on joint ownership as an easy solution. For example, in some national laws, jointly owned IP requires the parties to account to each other for any profits made from IP. This may not be desirable if the parties do not continue to work together.

## 1.4 Can you see the technology before you commit?

You or the other party will probably want to enter into a confidentiality agreement at the start of negotiations. Such agreements are legally binding commitments by one or both parties not to use or disclose to others the confidential information that they learn of during the negotiations. Such information may be technical prototypes, formulae, specifications, designs, scripts, experimental data and other technical information. It may also be sensitive business information, such as customer lists, business plans and strategies, or employee information.

**The confidentiality agreement enables you to examine the technology that you are considering licensing and thereby make good judgments about its specific nature, function, performance, and value.** You will also be freer to exchange business information. Just keep in mind that being too free with confidential technical or business information is not prudent even if there is a confidentiality agreement, because the agreement may not come to fruition.

Be wary of "stand still agreements" or other agreements that attempt to restrict your freedom to consider competitive alternatives during negotiations. These are seldom useful and can limit your negotiating leverage and flexibility, especially when negotiations continue over longer periods of time than initially expected (which they often do).

The key issues that arise with confidentiality agreements are:

1. Whether the recipient (the potential licensee to whom the technology is disclosed) is forbidden from using as well as disclosing the technology to others (use prohibition); and

2. The place where disputes are to be resolved (dispute resolution).

With respect to the use prohibition issue, the recipient generally wants to have freedom to walk away from the license deal and not worry about whether he or she is "tainted" by disclosures. The potential licensor wants to be sure that if the deal doesn't work out, his or her technology will be protected.

Dispute resolution is important because at the time of the confidentiality agreement, you don't know if the deal will be closed and you (especially the licensor) want to make sure that if there is a dispute about your IP, you do not have to travel to a distant and possibly biased jurisdiction to resolve it.

## 1.5 Do you need a license to use the trademark?

Do you need a license to use the name or logo of the technology or product in connection with the sale and distribution of your product or technology? If so, you are also negotiating a trademark license in addition to the technology license. You will need to specify what trademark and/or logos you need to use. This is important in **cases where the technology or product alone is not as valuable as the product distributed with a familiar trademark**.

If there is a trademark license, is there a certification program or other requirement that goes along with the right to use the trademark? Be careful of these; if there is a certification or other technical requirement, make sure that the specification and requirements are stated clearly as part of the license.

Similarly, do you need a right to use the industrial design of the licensor's product or technology? If the design is part of the commercial value of the product, make sure that this subject is covered.

Do you need the right to copy and distribute technical or other documentation related to the product or technology to users or others?

Do you need training, know-how or consulting from the licensor? (See Cluster 4, Issue 4.2).

# CLUSTER TWO: WHAT KIND OF RIGHTS DOES THE LICENSE GIVE?

## 2.1 What is the scope of rights?

Once you have determined the issues in Cluster One and have a clear understanding of WHAT you wish to license in or license out, **you will need to reflect on what you need to be able to DO with the IP/technology** in order to use it effectively in your business. This is referred to as the scope of the license. A license with broad scope gives you a great deal of flexibility. A license with a narrow scope will be less flexible but probably also less expensive. (See Cluster 3 below on financial terms).

An IP license includes several different "grants" of rights depending on the needs of the parties. These may vary as well depending on the IP laws that apply to the agreement; those listed below are representative of typical IP grants.

These grants may include the right:

- to reproduce the technology;
- to display it;
- to modify it;
- to make derivative works from it (making new versions or entirely new products or technologies by modifying and enhancing);

- to use it (for research and product development);
- to make it or have it made (for manufacture by licensee or contractor);
- to distribute or sell it;
- to import it; and
- to sub-license it to another who can do any or all of the above.

Sometimes these are referred to as patent grants (make, use or sell) or copyright grants (reproduce, modify, make derivative works, distribute), but it is not essential to divide them in this way. **The main point is what use does your business need?**

Perhaps your business only needs the **right to distribute the technology in its existing form (e.g. a distribution license** for a commodity product). Or, at the other end of the spectrum, perhaps your business model requires your engineers to make fundamental changes to the licensed technology, create new versions, and distribute these new versions to groups of sub-licensees who will also have the right to reproduce and customize the technology.

In either event, it is essential to decide: **what do you need to be able to do to the IP or technology in order to reach your business objectives?** You will need to review this list of grants and decide – together with the technical experts in your business – what rights are needed in order for you to take advantage of the business opportunity presented by the license. A license agreement is a very flexible business tool; the license may cover only part of a single IP right (e.g. the right to make a product covered by a patent, but not the right to have it made by others; or the right to reproduce a specification, but not to modify it).

Do you need the right to use it for research? **A right to conduct research and use technology internally is very limited without a right to make and sell products based on it.**

**Consider carefully whether your business requires the right to modify it and make new related products and/or technologies from it.** For example, will your technicians and scientists tell you that they must modify a formula or software or a design it in order to use it with your systems and technology? This is often called "porting" technology to another "platform". Even if they say only "minor modifications" need to be made, this can be important and must be dealt with in the license.

With respect to any modifications, who **will own these modifications?** Will the licensor have a right to use the modifications and derivative works made by the licensee (grant back)? If the license scope includes a right to modify, enhance, make derivative works, or improve an invention, even if the changes are minor, you will need to state in the agreement how the IP ownership of these modifications and improvements will be handled. (See Cluster 1, Issue 1.3 above).

Do you want to be able to **sub-license the technology** in its original or modified form to other persons? This is a difficult issue that is often not foreseen. Are there other entities that will have to be involved

in preparing your product and who will also need to have a license to the technology (e.g. research and development partners or distribution partners)? Will they need the same scope of rights as you have? From the licensor's point of view, it is a good idea to limit sub-licensing of important technologies because **broad scope sub-licensing risks loss of control and accountability for the technology**. In the same context, even without the right to sublicense, you may wish to have the licensed product made for you (licensee) by contractors. Normally, this right is inherent in the license grant, but the licensor may expressly exclude the right. You (licensee) may wish to include in the grant the right to "have made."

## 2.2 What is the territory?

Intellectual Property rights are often territorial. In what country or region do you plan to use the technology? If you are going to make products from the technology, where do you plan to manufacture? Where do you plan to sell? Do you plan to export the technology or products incorporating such technology? In what territory will you distribute the technology or products? **The license agreement must specify whether your rights are worldwide or limited to a designated country or countries, region, or other territory.** Limiting the license grant to patents of certain countries does not limit the territory in which the license may be exploited; if the licensee is to be limited to a specific territory, this should be specified.

For trademark licenses, where do you plan to distribute products bearing the mark or logo? The license agreement should be clear that you have the right to display the mark "in connection with" the sale of products throughout the territory.

For products that are to be distributed on the **Internet or in digital form or by electronic means**, it is important to specify in the license agreement that you have the right to distribute the product or technology in electronic form and on the Internet.

## 2.3 Is there an exclusivity commitment?

This is a complex issue where it is sometimes difficult to reconcile the interests of the licensor and the licensee.

In order to make your use of the technology profitable, do you need to have the exclusive rights to make, use, distribute, etc. (See 2.1 above) the technology or products containing it in a particular territory (See 2.2 above). If you are the licensor, is the potential licensee insisting that he or she requires exclusive rights in order to commercially exploit the technology or product? If so, in the negotiation, you will want to ask for **information and documentation that justifies this argument**.

Generally, from the licensor's point of view, an exclusive license is not desirable, because it restricts the licensor's freedom to do business with other licensees. Also, if the exclusive licensee fails to make good use of the technology, the result may be that the technology does not become commercially successful. The licensor is "putting all his eggs in one basket". However, there are a number of situa-

tions when an exclusive license makes business sense.

**Exclusive licenses are often considered where the licensee must make a substantial investment** that cannot be used for a different purpose (e.g. custom equipment, hiring specialized labor, committing resources to development of the technology, setting up a business in a new territory, conducting clinical trials and obtaining regulatory approval) in order to commercially exploit the technology. Whether an exclusive license is the only way to deal with these considerations depends on the financial projections of the licensee. How much money does the licensee need to make in order to amortize its investment and make a profit? If the licensee cannot make a profitable business from the license when he or she must compete with other licensees, an exclusive license, at least for a period of time, may be justified.

If an exclusive license is justified, the following are **strategies to limit some of the negative aspects of an exclusive license:**

- The exclusivity of the grant may be made dependant on the licensee achieving certain minimum royalty payments or product sales.
- The exclusivity need not last for the same term as the agreement and can be limited to a shorter time period during which the licensee can establish its business (a "head start" provision).
- The exclusivity can be for only some of the grants of the agreement or only with respect to certain technologies. Or, the license grant can be exclusive only within a specified "field of use" (e.g. an exclusive right to use the XXX technology in Ethernet based analog devices).

Keep in mind that exclusive licenses may be illegal, or subject to legal scrutiny, in some countries.

Related to exclusivity terms are **agreements not to compete or not to acquire or use competitive technologies.** Such provisions are sometimes illegal under national laws. They are also generally undesirable for licensees because they limit the licensee's ability to consider and develop alternative, possibly superior technologies.

## CLUSTER THREE: FINANCIAL TERMS

### 3.1 How much will the licensee pay for the use of the technology?

The financial terms of the license are often the first topics that are discussed when thinking of licensing. However, as can be seen from the above discussion, the financial terms in a license depend on how you have defined the subject matter (Cluster One) and the scope (Cluster Two).

One of the reasons why licensing is very different from sale of goods is that the price is not necessarily the most important term, because so many other important terms are involved each of which can have a drastic effect on value. For example, when you buy a CD, you prob-

ably know what you are buying and you probably know what you can and cannot do with it. You also know what the price should be because the markets for that CD are public. By contrast, in a license for rights to the contents of the CD, or the technology used to manufacture it or play it, the price you pay will depend upon whether you are negotiating the rights to all the content on the CD, and whether you want to reproduce, manufacture it, modify it, distribute it, or only listen to it. Or, you may be licensing the packaging or design, or the patents affecting sound quality. There will also be many different business elements related to the license. The many different IP aspects of the CD will present options for transactions that are as different as night and day. Also, the financial information on the value of the IP rights in the content is probably not public. For all these reasons, purely theoretical discussions of valuation methodology in technology licensing are not of much practical utility.

So, as a practical matter, how do you approach the question of valuation in a technology license?

You will need to consider the value of the IP license in the context of all the other related transactions: the financial terms will vary depending on whether there is only an IP license or also a manufacturing and purchase agreement, a marketing agreement, a distribution agreement, a joint venture, etc. As pointed out in Issues 1.3 and 2.1 above, the IP license is usually only a part of a successful technology licensing agreement.

Practical valuation also depends on whether you are the licensor or the licensee.

LICENSEE PERSPECTIVE: If you are the licensee, in deciding your position on the financial terms, **the first thing to assess is whether you can afford the cost that the license will add to the product or technology you are going to sell.** In other words, the first question for a licensee, is:

- how much can I afford to pay for this license,
- given the other costs that I will incur,
- considering the price that I will charge for the product,
- in the context of my assessment of what the market will bear?

This practical calculation is often not done until late in negotiations, leading to wasted time and energy as well as disadvantageous agreements that are simply too costly for the licensee. **It is better to start with this practical calculation of cost of goods sold than to begin by asking the abstract question of "how much is this technology worth"?**

LICENSOR PERSPECTIVE: If you are the licensor, you should know early in the negotiations what return you want for the value given. Obviously, this is a moving target, as the value given will change during negotiations; the licensor should have anticipated the relationship between return and the various values that might be given to the licensee. This may seem obvious, but many a licensor has become lost in the details of licensing discussions, only to find that the final result is an agreement that does not serve the licensor's objective of

obtaining a sound financial return on the value given to the licensee. In some cases, this may be intentional, as where the licensor is seeking to promulgate a technology standard, and anticipates losing money in the initial stages of a licensing program, but in other cases, this result occurs simply from lack of careful reflection on the financial terms during the preparation stage. Valuation methods are used to assist both the licensee and licensor in making these fundamental assessments.

There are several methods that are often referred to in order to value a technology. You should know what these are, but keep in mind that they are all subjective and not exact methods. Also, more than one method can be used and they can be combined. These methods are, at best, only rough guides, and common sense must always be applied. The three classic methods include:

## 3.1.1 The cost method

This is simply calculating how much the licensor has invested in developing the technology and the IP. Here the distinction between the IP and technology is important, as the patent or other IP itself may be all that is licensed so valuation based on the entire historical cost of technology development may not make common sense. Other common sense factors that affect how the cost of the IP is recovered relate to the licensor's other ways of recouping his investment and gaining profit – he may have other licensors, or may be exploiting the technology himself. Also, the mere fact that the licensor has spent a great deal of money does not necessarily bear any relation to the value of the technology to the licensee. Perhaps the licensor spent too much on R&D, or poorly conceptualized the relationship of the technology to the market (e.g., millions spent on developing smokeless cigarettes has no relation to the virtually zero market value of smokeless cigarettes). Finally, the cost approach is difficult because all of the licensor's statements about his or her investment may be perceived as self-serving by the potential licensee; how does the licensee know that the licensor is accurate and telling the truth? The potential licensee does not have access to the licensor's cost documentation, and if they are competitors may not want to know in order to avoid allegations of anti-competitive behavior. To sum up, the cost method may help the licensor in assessing his situation, but it's not likely to be persuasive to a potential licensee.

## 3.1.2 The income method

This method involves calculating how much the parties expect will be earned by the technology that is to be licensed and then dividing this up into percentages based on some notion (inherently subjective) of how much each party deserves based on its contribution to the technology, the stage of development of the technology, market risk, marketing, inherent value, strength of the patent against litigation attack, competing technologies, and many other factors. Some licensing professionals refer to a "rule of thumb" or rough measure which provides that the licensor should receive around one quarter to one third of the benefits accruing to the licensee. It must be emphasized that this

is so flexible a "rule" as to be almost useless. Many, if not most, licensees charge between 0.5 and 5 percent of revenues. The income method is a useful tool in figuring out a lump sum payment, where the parties need to envision the long-term value of the license, and then discount it to net present value.

It is useful in some cases to retain an accountant to develop income or net present value calculations which can be proposed and discussed in the negotiation of financial terms. One should not be surprised, however, if the other side is not impressed by these calculations or offers widely varying figures. Discussing such figures may simply be a way to initiate a constructive discussion on the future value of the technology to both licensor and licensee in the practical crucible of the marketplace.

### 3.1.3 The comparables or market method

This is what you do in shopping in a grocery store where you examine the tomatoes and compare then with the tomatoes you saw at another market. You are willing to pay a certain price for tomatoes of like quality. However, technology value is more complex and involves more unknowns than buying a tomato. It can be helpful to generalize and refer to industry norms and publications specific to the technology at issue. There are businesses that specialize in amassing royalty data. It is often possible to find articles or other resources concerning royalties or fees paid in similar transactions or involving similar technologies or similar scopes of license or involving similar regions, etc. The problem is to find a license or transaction that is comparable in all these respects. The technology may be similar, but the scope of the license may not be comparable, and so on. There is also the reality that not all IP is equal; a very strong and useful patent accompanied by a trademark license and an expert consulting contract will be more valuable than a pure IP license involving a weak patent that is currently subject to litigation and that can easily be worked around by a competitive inventor. The fact that these technologies are in the same technical field will have limited meaning in terms of valuation.

In addition to looking at the classical valuation methods, both parties will need to examine the practical realities of their respective businesses. For example, one question, very important for a licensor, is what will be the impact of a license agreement on the licensor's own sales of product. Licensing may mean introducing competition in one's own backyard. This can be good because it expands the market for a technology and may help establish a platform, bring in revenues that are not otherwise achievable, and may bring many other benefits to the parties. But the licensor must ask himself the question of whether it is in his interest to share the technology, and if it is, how will such sharing affect existing revenue streams from the technology or products incorporating that technology. This factor is sometimes called "cannibalization," meaning that the licensor may wish to consider whether the licensor's effort to get revenue for the licensed technology will empower licensees to competitively harm the licen-

sor's own product lines using the same licensed technology. Thus, in a cannibalization situation, the increased revenues to the licensor because of licensing are more than offset by the decline in the licensor's profit margin because of the existence of new competition that may be able to sell at a lower price.

It is apparent that IP valuation is not a science but a practical calculation based on examination of many questions. Only after these basic questions are asked, should the parties consider the form in which the payment will be made. (See below, Cluster 3, Issue 3.2).

## 3.2 How will the licensee pay?

There are two types of payments that are common in technology licensing: royalties and lump sum payments. These can be combined in different ways and taken together should reflect the fundamental calculation made in Issue 3.1, above.

Royalties may be based on per unit sales, a per unit royalty whereby the licensee pays a set amount for each unit of product sold. Alternatively, the royalty may be a percentage of revenues from products sold or sub-licensed that incorporate the licensed technology.

Royalties may be assessed based on gross or net prices or revenues (after subtracting various costs such as shipping, customs) but it is important to define how net prices or revenues are determined and to specify exactly how the royalty will be calculated, including providing sample calculations in an exhibit to the agreement.

The licensee will often want a provision **"capping" the royalties** that must be paid to the licensor. This means that the licensee will pay X percent of his product sales up to a certain fixed amount. This "cap" may be renewed annually or may be over the life of the agreement. The licensee likes a cap because it gives him the prospect of using the technology "free" after a certain period of successful sale of the product incorporating the licensed technology. Also, it creates a more certain business model – the licensee knows what he will be paying. The licensor does not like caps because it limits his "upside", his chance of gaining royalties substantially in excess of his investment in the technology.

The opposite of a cap is a **"minimum"**. Just as the licensor does not like a cap, because it restricts his upside, he does like a minimum royalty because it limits his "downside". In other words, even if the technology or the market is disappointing, he is guaranteed a certain minimum royalty. Minimums are often used when the license is exclusive. (See Cluster 2, Issue 2.3).

**Royalties may also be adjusted** according to a number of variables, such as time or product sales or revenues. So, for example, a royalty may begin at 2% of the average sales price, but decrease to 0.5 percent over the life of the agreement, reflecting the declining value of the technology. Or royalties may be adjusted according to product sales, with a higher royalty to be paid if the volume of sales is low.

**Lump sum payments may be used instead of, or in addition to, royalties.**

A lump sum payment may be made at the beginning of an agreement or at a later stage. Such payments may be in installments. Installments may be timed to coincide with development milestones. (See Cluster 1, Issue 1.2).

**Lump sum payments may also be "advances" against royalties.** Where the licensee is in a stronger financial situation than the licensor (e.g. a start–up licensor with a new technology) sometimes the licensee will pay an advance at the beginning of the agreement to get the licensor started in business or to bridge a difficult financial situation, or to enable it to pay engineers, chemists, etc. to conduct further development of the technology (see Cluster 1. Issue 1.2). This advance can be offset against royalties that the licensee would otherwise have to pay the licensor, until such time as the advance (in effect a loan) is paid off. In such cases, parties will often debate who owns the resulting technology: does the fact that the licensee advanced the funds justify that it should own the IP? Or is it more significant that the advance was merely a loan that is repaid when royalties begin to accrue? Advance royalties are also used where the licensee may be financially unstable; the licensor is guaranteed at least the advance even if the licensee fails to pay future royalties based on sales.

## 3.3 When to use cross licenses and covenants not to sue?

Cross licenses are where neither party pays the other from the license rights, but rather both parties exchange license grants of approximately equal value. An example of this is where the parties both have patents that may be infringed by the other party's patent. They agree to exchange these rights, so that neither party can sue the other. This right may extend to the customers and distributors of each party. This is, in effect, a "truce" agreement where the financial value that is exchanged is the value of the royalties that each side gives up. Instead of a cross-license, it may be a cross "covenant not to sue".

In entering into such an agreement, it is important to recognize that it is a financial agreement like any license agreement, because you are agreeing to relinquish your right to collect royalties for your IP from the other party and, in most cases, from his customers and distributors. Where there is unequal value in the respective patent portfolios, the party with the lesser patent values may agree to supplement its license grant with some form of payment.

On the other hand, such agreements are often the basis for business partnerships and joint ventures that may lead to profitable exploitation of the technologies of both parties.

## 3.4 What are performance/ warranties/indemnities?

Although the issues related to warranties and indemnities can be legally complex and the drafting of such provisions can challenge the most adept expert, it is simpler to think of these issues as essentially financial ones. Considered in this way, the issues are:

- Who will bear the financial risk of a product or technology defect?
- Who will bear the risk of a defect in title to the product or technology?
- Who will bear the risk that a third party will bring a legal action claiming that the technology or product infringes his patent or other IP?

The first of these questions relates to the nature of the technology to be licensed. Warranties are often used to address problems that are more appropriately treated in the context of subject matter definition (see Cluster 1, Issues 1.1 and 1.2) or changes to the technology over time (Cluster 4, Issue 4.1). The sort of issues that arise include: Who is responsible for defects in the functioning of the technology? Who will pay engineers to deal with software bugs or non-functional hardware? Is there a guaranteed "uptime" for web-based products? For biotech technology, what functions must the technology perform? Who will be responsible for property damage or personal injury? With pharmaceutical products and technologies, such liabilities can be substantial. All of these are technical questions and even with the best thought-out product technology, problems will always arise. **The issue then is deciding who will pay the expense and assume the responsibility for handling these?**

The other two aspects of warranties raise the question of who will bear the risk of legal and business expenses should there be a question about the originality or ownership of the product or technology (see Cluster 1: Issue 1.3 re ownership).

There is no set answer to all of these questions. Nothing is "standard" or "customary". Of course, the licensor wishes that the licensee should bear the risk. The licensee argues that the licensor is responsible for knowing how his product works and who created it and whether its IP is infringing. From the licensee's perspective, it is generally riskier to assume these risks if the product is new, complex, customized, or in a controversial, highly competitive area. Commodity products or distribution licenses of products that have been licensed out for years generally raise fewer risks. Often, a license agreement will include a representation that no claims have been made. This may or may not give the licensee comfort that none will be made in the future. In this area, as in others, it is essential to work with legal counsel to assess the financial risk, develop a sound position, and draft precise language.

## 3.5 How does licensing relate to financing of joint ventures and corollary activities/pricing of products?

Generally, a licensing agreement is in the context of a larger business relationship. The license agreement may include or be accompanied by an agreement whereby one of the parties seeks investment or financing. The parties may also envision a supply relationship where the licensee agrees to provide access at preferential pricing to products developed and manufactured using the licensed technology or IP.

Do the parties anticipate agreements related to manufacturing or distributing products based on the technology? Do the parties anticipate investment transactions in which one party pays money in exchange for equity or IP or other assets?

**In such cases, it is important to think through these related relationships and, to the extent possible, clarify and reach agreement on the terms of such relationships in advance. This clarification and written agreement should occur before beginning work on technology development or product development based on licensed technology.** The reason why this is important is that an agreement on an IP license may or may not be satisfactory if ultimately an agreement on investment is never reached. Does the licensor need investment or financing as part of the agreement in order to complete development of the technology? Conversely, does the licensee need financing in order to exploit the technology? Does the licensee need funding in order to exploit the commercial opportunities of the technology? Does one or do both parties expect that stock or warrants will be issued by the other party in its favor?

Similarly, if access to products at discounted pricing is an important part of the bargain for one or both parties, it is desirable to address this issue and attempt to create a pricing agreement or formula at the same time as the license.

**The successful license negotiator must think broadly as to what other agreements are important to put into place in order for the overall business transaction** (not only the IP or technology license) to be financially advantageous. Good financial terms on an IP license may be spoiled if it turns out that other agreements that are necessary are too costly.

## CLUSTER FOUR: TECHNOLOGY'S GROWTH AND DEVELOPMENT OVER TIME

### 4.1 Will the licensee receive rights to future releases, versions and products?

The licensee will be concerned that as soon as he licenses in a new technology, the licensor may come out with another release, version or product and offer it to a competitor of the licensee. Or, he may understandably be concerned that the licensor's new offering will render the "old" licensed technology product obsolete soon after he has made an investment in it. The licensee ideally wants to receive broad rights to new variations, improvements, and related technologies. The licensor wants to limit its commitments to the licensee because, for the sake of the health and vitality of its business, it must be able to innovate and change directions and technologies in the future.

**It is important to clarify: will the licensee have rights to future versions of the technology or product?** In a pure IP license, it must be clear whether the licensee will have a license to improvements or derivative works.

Generally, licenses address these issues and refer to releases, versions, and new products or other terminology appropriate in the trade to describe improvements and related new technologies, inventions, works, and products.

Will such versions or new products require additional payment? If so, is it possible to fix the payment at this time? Often it is not possible to anticipate and negotiate payment for new versions and developments. In such cases, it is not possible to enter into an agreement for such future developments.

**Avoid agreements to agree in the future,** as generally such commitments are not enforceable in the absence of a clear financial agreement.

Another issue that arises is whether the licensee has access to all future versions at the same time as other licensees. Agreements often provide that the licensee will have **parity access**, meaning access at the same time and on comparable terms to new versions and developments.

## 4.2 Are service and support/ spare parts included in the license?

Will the licensor provide service and support in the use of the technology or associated products? Will the licensor provide assistance in monitoring and servicing the licensed technology? For example, in web-related technology, will the licensor be required to respond to emergencies in which web access fails? Will a certain number of staff be devoted to correcting bugs, bringing systems back to operation, fixing defects, and so forth? Will service and support cost extra? Is there an annual service/maintenance fee? Sometimes these issues are addressed in a separate service agreement.

If a product is being developed or manufactured by one of the parties, will the product need spare parts over time, and if so, what provision will be made for the manufacture and/or purchase of spare parts?

## 4.3 How to deal with documentation, know-how, consulting and training?

Often the parties will focus so hard on the IP that is to be licensed that they neglect **the non-proprietary information that will be exchanged between the parties.** For example, a new licensee may require assistance from the licensor in terms of know-how, training and consulting to make the technology or product practically useful and functional. It is important to determine:

- Does the licensee need help from the licensor in terms of written documentation or materials that help him understand how to use the technology?
- Does the licensee need the know-how of the licensor in order to exploit the technology?
- Does the licensee need or desire to have licensor personnel available to work with its employees?
- Who will own any IP results of such joint work? (See Cluster 1, Issue 1.3)
- Will the licensee wish its employees to be trained by the licensor in the use of the technology? If so, how many hours?

## 4.4 What special terms relate to the future relationship of the parties?

Is there a non-compete provision whereby one party demands the other agree not to work for competitors? Such restrictions are illegal in some national jurisdictions. They are, in any case, to be avoided because they restrict the ability to negotiate alternative business relationships.

Sometimes parties will agree not to solicit or hire each other's employees. These can be important provisions especially where the human capital of one party is very important to its success.

**The above list is not exhaustive, but it is an overview of important issues.**

**Work with your team to see which apply to your case. Work through the pros and cons yourselves before moving on to the next step of negotiation with the other side. Review terms in advance of negotiation with legal counsel.**

# IV. Conducting the Negotiation

## The Advantage Continuum

Technology licensing negotiations are complex because there are many key terms and because for each key term there are many possible positions that may be taken, from the most advantageous to the least advantageous. **The negotiator has the difficult task of keeping in mind many different key terms and positions, dealing with technical subject matter, and constantly assessing the way the key terms affect the business objectives of the license.** The following continuum represents the range of positions for each key term.

The goal of the negotiator is to stay as much as possible on the right side of this continuum with respect to *each key term*, while recognizing that the other side will attempt to achieve the same goal with respect to the *same set of key terms*. Despite the apparent contradiction in these goals, success is possible in many cases because both parties do not have identical business objectives with respect to the same key terms. What is advantageous for one party is not necessarily disadvantageous for the other party with respect to any given key term. In other words, negotiation could not succeed if there were only one key term with one continuum from advantage to disadvantage. However, the reality is that in any technology licensing negotiation there are actually many key terms, each of which has a continuum from the most advantageous position (5) to the most disadvantageous position (-5), with several variations in between.

**It is this multiplicity of positions that makes negotiation complex and also that makes it possible to reach agreement.** Adding to the complexity is the fact that some key terms are more important than others for your objectives, so that a high number on that key term may weigh more than on another key term. A negative number on that key term will likely indicate that the position is an unacceptable one.

## Fall-back Positions and Compromise

With respect to some key terms you will have fall-back positions that reflect an advantageous position that is less than optimal, but still acceptable in terms of your objectives.

Or where there is a direct conflict between the goals of the parties with respect to a particular term, that term is not so important to either party that a "compromise" on a key term is impossible. **You may decide to accept a compromise with respect to a certain key term, that is, take a position that is not advantageous (a negative number in the above continuum), but that is acceptable in the context of positions taken on other key terms.**

**Example:** It may be most advantageous to obtain a license to all the IP related to a product that you wish to manufacture and sell. It may also be ideal to obtain a perpetual term. However, as a practical matter, you may only require a license to one aspect of the technology or only one patent because you do not intend to commercially exploit all aspects of the technology. And the term may be limited to five

years because as a practical matter, you will not need the license beyond that time period. An acceptable fall-back position, which can be offered at some point in the negotiation, may be to limit the scope of the license to what you need and only for the five-year term. On the other hand, you know that you will need the right to modify the technology because without modification it will not work with the technology that you already have and the other party is unwilling to assist you by making the necessary modifications. This key term, then, is very important. A fall-back position might be to offer that the other side will have IP rights to any modifications that you make to the technology. In that case, it will be important to assess whether your enterprise's competitive position could be harmed by others having access to the modifications that you make. If yes, the license may not be worthwhile in terms of your objectives and a successful conclusion may be to withdraw from the negotiation after attempts have been made to explain your needs and requirements to the other party.

It is sometimes useful for a team to use a numbering system as an *internal* tool in a negotiation; assigning numbers to various key terms and summing the numbers based on the entirety of the term sheet may help the team sort through difficult decisions in a thoughtful manner. However, these sorts of systems can become too mechanical and the negotiators may become unable to think analytically about the advantages, disadvantages and, most important, practical consequences of positions on various key terms.

## Failure Can Mean Success

In some cases, the parties' bottom line positions on key terms will conflict. In that case, the best outcome of a negotiation may be withdrawal from the negotiation, and where possible, withdrawal to an alternative solution or party. **Withdrawal from negotiation is not equivalent to failure.** The negotiating team may make a decision that the negotiations cannot succeed except at the sacrifice of the important objectives and bottom-line positions of the negotiations. Such a considered decision must be deemed a business success, rather than a negotiation failure. Conversely, the decision to persist to the conclusion of an agreement because of the negotiator's personal involvement or commitment to the negotiation process, where objectives and bottom-line positions cannot be achieved, must be considered a failure.

## How Adjustments and Changes Can be Made

In many cases, you may adjust your perception of the variations available with respect to a key term. This is often because you learn new facts. A position that was not at first evident, a creative opportunity, may become apparent during the course of the negotiation. Sometimes, this is called "thinking out of the box" and refers to using imagination to get around a stalemate where the parties cannot find a compromise on a key term. **Be wary of finding creative alternatives on the spur of the moment, especially when you are tired or are in the heat of personal interaction in a negotiation session.** Given

careful preparation, the term sheet should reflect a good assessment of the continuum of positions on each key term, so that surprise solutions should not be expected.

## The Myth of Negotiating Style

The commonly held belief that negotiation is influenced by negotiation style in a battle of wills or style is a myth that leads to mistakes and wasted energy in negotiation. **Always enter a negotiation with the assumption that the other side's team is as resolute and as skillful as you are.**

As is evident from the discussion in Sections I to III, successful negotiation requires you and the team to make constant mental reference to the positions on the key terms, and to make frequent use of the term sheet as a guide.

Your ability to analyze and recall the relationship of the key terms to your business objectives will dictate the success of the negotiations. This is true for three reasons.

**First**, you will know your position and the possible fall-back positions and compromises.

**Second**, successful negotiation involves being able to explain your enterprise's needs and objectives to the other side at the appropriate time in a clear and convincing way. Given the solid preparation you will have because of the term sheet, you will be able to give this explanation cogently.

**Third**, thorough preparation will increase your confidence and project competence. You will not have to raise your voice for the other side to know that you mean business. Your evident understanding of the needs of your business will show that in the most effective manner.

**The single best determinant of a successful negotiation team is thorough preparation through use of a term sheet involving a complete understanding of the positions of both sides as to each key term, as well as an assessment of the leverage of each side in the negotiation.**

## How to Start the Negotiations

**It is useful to start with a preliminary meeting.** This is a meeting where you attempt to reach procedural agreements that will help make the negotiation a successful experience for both sides. You may present and sign confidentiality agreements. (See Section II, H). You will also use the preliminary meeting to introduce the other side to your business objectives and likely positions on the key terms.

Discuss and decide upon a negotiating schedule and deadlines. Discuss and decide whether the negotiations will be in person, by correspondence, all at one time (over a period of days) or spread out over a longer time period. Generally, if there is a business deadline (e.g. R&D must begin by a certain date) it is best to agree to negotiate in person over a period of days.

In a low-key and informal manner, introduce the other side to your business objectives in seeking to enter into the license

and invite the other side to do the same. Of course, neither party will disclose detailed business information, nor is it appropriate at this stage to discuss the key terms in detail. However, an overview of your objectives (e.g. "our company is interested in this technology because we see it as an opportunity to manufacture and distribute XXX in Y market which is currently not being served") will help set the framework for the negotiations.

Offer the other side a copy of your term sheet (an external version, drawn up to delete any references to negotiating positions or other internal information) at the beginning of the negotiation. You can informally explain the term sheet and, at that time, you will explain why certain key terms are important to you. In essence, you are introducing the other side to your business objectives in the license (your framework). You may refer back to this framework later in the negotiations.

## Where and How to Hold the Negotiations

If there is time pressure in completing the negotiation, it is important to hold it in person over a period of days. Negotiations that are interrupted and then carried on by correspondence tend to be protracted. **So an in-person negotiation in which both sides agree on time goals and deadlines works most effectively to get closure.**

The location of the negotiations is not critical. However, it is important to have access to the materials you have collected (see Section II, D) and the members of the team. The location must also be comfortable, close to eating and toilet facilities. It is useful to have a portable computer in the room to keep notes and to consult the term sheet and, eventually, the contract draft.

## How to Discuss the Key Issues

In the second session you begin to discuss the key terms. There is no special procedure for doing this. Some negotiators prefer to go through all key terms first and have general discussion without seeking closure. Others prefer to go through each key term in order and try to reach agreement on each in that order. If agreement cannot be reached, then it is often useful to continue through the term sheet to see what agreements may be reached and then return at the end to the difficult issues. Some negotiators will wish to start immediately with a contract draft; if at all possible avoid this as it is often a stratagem to control the framework of the agreement and to apply pressure to gain advantage on key terms. **Try to persuade the other side of the advantages of beginning discussions with a term sheet as a tool for both parties to clarify the issues.**

Each party presents his or her position with respect to a key term and explains why it is important to the achievement of his or her side's objectives. Tactics that involve simple assertion of a position and a demand for agreement are seldom effective unless there is a great inequality in leverage. Similarly, it is not persuasive to assert that a certain provision is "standard" or "customary", as there are many variations for each term in technol-

ogy licensing. For this reason, it is useful to refer back to the preliminary meeting where you explained the framework – your business objectives and needs. That way, your positions are seen as reasonable and coming from your business needs, as opposed to appearing arbitrary and based on a contest of wills. Of course, the fact that you have asserted your business objective does not mean that the other side must agree to your position. However, a good framework does make your position clear and reinforces your commitment to the position. It also establishes, with a professional negotiator, a rapport that makes it difficult for him to continually demand that you accept positions that are not consistent with your business objectives.

It is also essential to listen to and understand the other side's explanations of its positions. Ask how the other negotiator's positions refer to his or her business objectives, his framework. That way, when a specific issue arises you may be able to respond to the issue by showing that a particular solution is consistent with both parties' business objectives.

It is not possible or desirable to explain everything about your business objectives. However, some reference to your business objective is often helpful.

## Write Down Progress and Take Notes

In a multi-day negotiation, you may wish to exchange notes or keep track of tentative agreements by updating the external version of the term sheet and giving the other side a copy the next morning for their review.

**When you make progress on a key term, it is often useful to restate the parties' positions and write them down.** If what appears to be a real agreement is reached, it is important to write this down in note form. In protracted negotiations, keep a log of what discussions are held and what tentative agreements are reached.

The parties work through the term sheet, reach tentative agreements on key terms, and modify the term sheet as they go along. Taking breaks is important. A team member uses a portable computer to take notes and write modifications. Some issues may need to be deferred if agreement cannot be reached, and it is often helpful to turn to other issues to see what progress can be made. After the term sheet is modified and the parties feel that there is a basis for moving to the contract draft, do not sign the term sheet. Move on to the drafting stage.

## The Role of Lawyers

Ideally, it is important to involve lawyers from the beginning of the negotiations until the end. If this is not possible, it is essential to communicate frequently with legal counsel, to use the term sheet, and to have a thorough legal review before drafting the contract and during the drafting process.

## How to Close the Deal and Draft the Agreement

If the parties have worked with a term sheet, and have recorded tentative agreements, the drafting of the agreement should, in theory, not be difficult. Do not

sign the term sheet. Experienced legal counsel can work efficiently to prepare the technology licensing agreement from the term sheet.

With respect to key terms make sure that you have reached agreement, not merely agreement to agree at some point in the future. An agreement that does not cover the key terms may not be enforceable. Also, lack of clarity on key terms often leads to business conflict.

Remember that an agreement that is not signed by both parties is not an agreement except in limited situations. A common error to be avoided is thinking that a negotiated written document is “enough” to start performance even though one or both parties have not signed.

# V. Understanding the Impact of Competition Laws on Technology Licensing

## Introduction

In most countries, there is a growing consensus on the complementary role of intellectual property protection and sound competition policies to promote innovation and consumer welfare. The following excerpt from a European Commission draft communication[3] illustrates how the interface between intellectual property and competition can be described:

*Intellectual property laws confer exclusive rights on holders of patents, copyright, design rights, trademarks and other legally protected rights. The owner of intellectual property is entitled under intellectual property laws to prevent unauthorized use of its intellectual property and to exploit it, inter alia, by licensing it to third parties.*

*The fact that intellectual property laws grant exclusive rights of exploitation does not imply that intellectual property rights are immune from competition law intervention […] Nor does it imply that there is an inherent conflict between intellectual property rights and […] competition rules. Indeed, both bodies of law share the same basic objective of promoting consumer welfare and an efficient allocation of resources. Innovation constitutes an essential and dynamic component of an open and competitive market economy. Intellectual property rights promote dynamic competition by encouraging undertakings to invest in developing new or improved products and processes. So does competition by putting pressure on undertakings to innovate. Therefore, both intellectual property rights and competition are necessary to promote innovation and ensure a competitive exploitation thereof.*

*In the assessment of licence agreements under [competition law] it must be kept in mind that the creation of intellectual property rights often entails substantial investment and that it is often a risky endeavour. In order not to reduce dynamic competition and to maintain the incentive to innovate, the innovator must not be unduly restricted in the exploitation of intellectual property rights that turn out to be valuable. For these reasons the innovator should normally be free to seek appropriate remuneration for successful projects that is sufficient to maintain investment incentives, taking failed projects into account. Technology licensing may also require the licensee to make significant sunk investments in the licensed technology and production assets necessary to exploit it. [Competition laws] cannot be applied without considering such investments made by the parties and the risks relating thereto.*

*[…] There is no presumption that intellectual property rights and licence agreements as such give rise to competition concerns. Most licence agreements do not restrict competition and create pro-competitive efficiencies. Indeed, licensing as such is pro-competitive as it leads to dissemination of technology and promotes (follow on) innovation. In addition, even licence agreements that do*

3 Draft Communication from the Commission, Guidelines of the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, available at *http://ec.europa.eu/competition/consultations/2013_technology_transfer/guidelines_en.pdf*.

*restrict competition may often give rise to pro-competitive efficiencies, which must be considered and balanced against the negative effects on competition.*

## 1.1. Competition law – concept and its interface with intellectual property (IP)

From the perspective of competition law (or antitrust law, as it is known in the United States and other jurisdictions), the technology licensing process has the potential and often does increase the ability of both partners to compete with each other as well as with other competitors.

Generally speaking, competition law is intended to protect the process of competition from unreasonable restraints. Although competition law is essentially a matter of national legislation, some substantive principles are recognized worldwide. Therefore, competition law is generally understood as a set of rules designed:

1. To prohibit:
a) restrictive agreements or arrangements among parties whose objective is to prevent, restrict or distort competition, and
b) abuses of a dominant position; and
2. To control mergers and acquisitions that may limit access to markets or otherwise unduly restrain competition, with a possible adverse effect on domestic or international trade and economic development.

### Competition law – some definitions

Despite the absence of international competition legislation, there is a general consensus on most of the substantive issues related to anti-competitive practices.

Market dominance (which is not unlawful in itself) is understood as the ability to raise and maintain prices above the competitive level in a relevant market. An abuse of such a dominant position may arise from efforts to limit production or technical development, to discriminate among third parties in the relevant market, to impose undue contractual obligations (*e.g.*, a non-compete clause in a license agreement that is unreasonable in terms of duration or the geographical area it covers); imposing excessive, unfair or predatory prices which in some jurisdictions (*e.g.*, the European Union) is also considered an antitrust violation.

The relevant market covers both the relevant product market and the relevant geographic market. The relevant product market comprises all those products or services which are regarded by the buyers as interchangeable in terms of characteristics, prices and intended use. The relevant geographic market covers the area in which conditions of competition are sufficiently homogenous. For instance, in a technology market, the relevant market could be defined as the licensed technology and competing technologies outside of the agreement in a given (*e.g.*, nation-wide) area.

Generally, agreements or concerted practices among competitors are unlawful only when they actually or potentially affect competition agreements among competitors (sometimes called "horizontal agreements") are subject to greater scrutiny because of the ease with which such agreements can adversely affect competition. Agreements among companies that do not compete, such as suppliers, producers and distributors (sometimes called "vertical agreements") are not as likely to cause competitive harm. Nonetheless, all agreements may be subject to administrative or judicial review if they have an anticompetitive effect.

Usually, the anti-competitive effect of an agreement in a relevant market is evaluated on a case by case basis (called Rule of Reason in the U.S.), according to the content of the agreement and the participants' relative market power. Such evaluation often requires a detailed legal and economic analysis of the effect of the agreement on competition. Certain contractual arrangements (in particular, price fixing agreements) have been identified as hardcore or *per se* anti-competitive and are declared illegal without such a careful evaluation.

## Pro-competitive agreements[4]

Agreements between firms may be permitted to develop uniform product standards in order to promote economies of scale, increased use of the product and diffusion of technology. Similarly, firms may be allowed to engage in collaborative research and development (R&D), exchange statistics or form joint ventures to share risks and pool capital in large industrial projects. These exemptions, however, are generally granted with the proviso that the agreement or arrangement does not form the basis for price fixing or other practices that are restrictive of competition.

An owner of intellectual property or technology is, generally speaking, not obligated to grant licenses or otherwise permit others to use the intellectual property or technology because intellectual property rights grant in their essence the right to exclude others from the use of the protected intellectual property.[5] Technology licensing, therefore, is generally considered pro-competitive as it multiplies the number of users of the intellectual property or technology.

However, a negotiator, either on behalf of the licensor or the licensee, should be aware of the fact that certain clauses in licensing agreements might be deemed anti-competitive. Those constraints may be caused by two different factors.

First, in certain jurisdictions, authorities (*i.e.*, governments and courts) consider intellectual property rights as the source of significant market power (or dominant position, in the language of competition law). However, the mere possession of a patent, for example, does not automatically provide market power. In fact, if there

4 OECD, Glossary of Industrial Organisation Economics and Competition Law, 1999

5 Despite the general principle that owners are not required to license, the laws of some countries provide for compulsory licensing under narrow circumstances.

are several competing technologies in a given market, patent owners might not enjoy any market power whatsoever. On the other hand, if there are no or only few competing technologies on a given market it is possible that a patent owner enjoys a certain degree of) market power. Therefore, certain clauses that are merely expressions of exclusivity generated by intellectual property can be deemed as a potential abuse of monopoly power. For example, in certain jurisdictions, an exclusive license agreement which grants exclusivity in a geographic area to the licensee may be perceived as a restraint on competition. A negotiator should therefore be aware of the countries in which such attitudes exist.

Second, even where authorities do not take the one-sided approach of seeing intellectual property as synonymous with market power, authorities in some jurisdictions have established guidance as to the adequacy of certain clauses of licensing agreements. Such guidance may be more or less permissive with regard to negotiating freedom (*e.g.*, regarding clauses on royalties, non-compete arrangements, exclusivity). However, a negotiator should be aware of the guidance provided by the government, by competition authorities, and/or, in certain countries, by industrial property offices.[6]

## Exclusive and Non-exclusive license

*Example 1 – Exclusive license*
Licensor hereby grants to Licensee, subject to the terms and conditions of this Agreement, an exclusive worldwide license under the Licensed Patents and Know How, to manufacture, use, sell, and offer for sale and import Licensed Products for any and all uses.

*Example 2 – Exclusive license to become non-exclusive after five years*
Licensor hereby grants to Licensee a license for the manufacture, use, sale, offer for sale and import of the Licensed Products. The License will be exclusive during the first five years starting from the date of this Agreement. At and after expiration of this time period, and for the same territory, the License will be non-exclusive.

*Example 3 – Non-exclusive license*
Licensor hereby grants and Licensee hereby accepts a non-exclusive license in each country of the Licensed Territory under the Licensed Patents to produce, have produced, to manufacture, have manufactured for it, to use, to sell, to offer for sale and to import Licensed Products.

6 For the United States see *www.justice.gov/atr/public/guidelines/0558.htm*, for the European Union *http://ec.europa.eu/competition/antitrust/legislation/transfer.html* and *www.epo.org/learning-events/materials/inventors-handbook.html*, for Brazil *www.inpi.gov.br/menu-esquerdo/contrato/copy_of_index.htm*, in Portuguese, for Japan, see *www.jftc.go.jp/en/legislation guidelines/ama/070928_IP_Guideline.pdf*.

Generally speaking, exclusive licensees do not have anything to gain from challenging and obtaining an administrative or court invalidation of the title (IPR ownership) of the licensor, when the license agreement (*i.e.*, the contract of technology transfer) includes one or more patents, as, among other things it will potentially jeopardize the monopoly position of the licensee on the market. Nevertheless, in principle, the licensee should be free to challenge the validity of the licensed patents. In many countries, a provision precluding such a challenge is unenforceable, but given that some countries preclude a licensee from challenging the licensed patents, including such a "no challenge" provision is advisable in a worldwide license agreement.

## 1.2. The "per se" and the "rule of reason" approaches

As a general legal concept, allegedly anti-competitive conduct involving use of IP can be approached in two different ways: under the *per se* approach or under the *rule of reason*.

The so-called "*per se*" approach applies to certain forms of anti-competitive behavior that are so outrageously abusive and harmful to competition that they do not require from authorities (or courts) an analysis as to their effects – they are banned *per se*. Two of the most common examples of such practices are agreements between competitors to fix prices or to allocate markets.

On the other hand, the "*rule of reason*" requires an assessment of the likely or actual anti-competitive effects in the relevant markets. Depending on that assessment, certain practices may be acceptable in spite of creating restrictions or limitations to the competitive environment.

## Rule of Reason and *Per Se* Approach[7]

[Rule of Reason:] A legal approach by competition authorities or the courts where an attempt is made to evaluate the pro-competitive features of a restrictive business practice against its anticompetitive effects in order to decide whether or not the practice should be prohibited. Some market restrictions which *prima facie* give rise to competition issues may on further examination be found to have valid efficiency-enhancing benefits. For example, a manufacturer may restrict supply of a product in different geographic markets only to existing retailers so that they earn higher profits and have an incentive to advertise the product and provide better service to customers. This may have the effect of expanding the demand for the manufacturer's product more than the increase in quantity demanded at a lower price.

The opposite of the rule of reason approach is to declare certain business practices *per se* illegal, that is, always illegal, without any further enquiry into the circumstances or the impact of those practices. For example, price fixing agreements are in most jurisdictions *per se* illegal.

As a general tenet, the "*rule of reason*" approach is preferred over a strict *per se* approach. Although certain contract clauses may appear anti-competitive, a legal and economic analysis under the rule of reason might lead to a different result. An analysis of the allegedly anti-competitive clause might show that its pro-competitive effects outweigh its anti-competitive effects. For example, it is usually believed that a patent licensing agreement cannot require payment of royalties after expiration of the patent protection period. However, it may be more beneficial to the licensee to pay a reduced amount over a longer period of time as opposed to paying a higher amount over a shorter time. If the licensee voluntarily agrees to pay royalties for a period of time that extends beyond the life of the patent in order to agree on a lower royalty rate, the obligation could be pro-competitive. For instance, the licensee might not have been able to enter into the license agreement if the royalty had been higher. In such a scenario, it is essential that the contract clearly reflects this bargain.[8]

Another example may be the obligation imposed on the licensee to buy a second undesired distinctive technology or product, which is called a 'tying arrangement'. In such a situation, the intellectual property owner uses his market power in one market to license a technology in another market where the intellectual property owner does not have market power. Thus, a licensee would be forced to enter into a license agreement regarding a technology or product he did not want to license ini-

7 OECD, Glossary of Industrial Organisation Economics and Competition Law, 1999

8 In the U.S., even a voluntary agreement to pay royalties for use of a patented invention after expiration of the patent is considered a "misuse" of the patent, rendering the patent unenforceable. This application of the principles of patent misuse has been questioned by courts, but remains the law as of this publication date. The parallel enforcement regime of patent and copyright misuse appears to be unique to U.S. law.

tially only to be able to license the desired product. Such tying arrangements are generally regarded as anti-competitive. There is a general consensus that tying agreements are prohibited only when the licensor has a dominant position on the market of the patented products and wishes to use it to acquire a relevant share of the secondary market. The "rule of reason" approach is preferred over the "*per se*" approach because there are several instances where a tying arrangement may be pro-competitive. This is the case, for instance, when multiple licenses from different IP owners are needed to use any single item of a complex technology. Overall, tying arrangements are considered with suspicion particularly when the licensor can exert a significant leverage over the licensee because of its market power. If a tying clause is challenged, it is important to underline that the burden of proving the pro-competitive effects of the bundling rests with the licensor.

The "rule of reason" naturally suits better the analysis of contracts of technology licensing. The reason is that the legal parameters that serve as the basis to analyze questions related to antitrust violations – market power, barriers to entry and other market conditions and market share – do not necessarily apply to matters involving the use of IP rights. The dynamic efficiency arising from successful technology licensing – expressed in many of the benefits listed before – may justify certain practices that, in different contexts, could be rejected by policy makers and/or competition authorities. This is mainly due to the fact that in dynamic markets which typically involve IPRs the market power that may be exerted by individual companies may be much less significant than in traditional goods and services industries where market shares tend to be more stable over time.

As a negotiator, one does not need to know in detail all the complex aspects of and different approaches to competition law (for that, one should be assisted by a lawyer at the contract drafting stage). But the negotiator does need to know that there are different approaches possible and should be aware of the general disposition of the government and courts in whose jurisdiction the contract will be effective and the obligations will be performed. Moreover, a negotiator should be able to express the positive elements of certain more difficult clauses in the contract – for example, in the Preamble one can describe the advantages for one's company and for the market niche aimed by the contract in question.

## 2. How does competition law impact licensing agreements?

Certain anti-competitive practices by licensors are easy to detect. What negotiators need to be aware of is that there are lists of prohibited practices and clauses, as well as of practices and clauses that may be scrutinized as to their potentially anti-competitive effects in certain countries. For example, restrictions concerning exports by the licensee and requirements to purchase from a specified source ingredients (raw materials or spare parts) necessary to exploit the licensed technology (known as "tying" or "tie-ins")

are special (but not uncommon) clauses that may be considered by governmental authorities (and courts) as potentially anti-competitive.

More general clauses, such as the amount of royalties paid or other financial considerations (such as payments in the form of licensee's shares) as well as, in some less common cases, the very choice of the technology to be acquired by the licensee, may also be questioned.

In fact, in certain developing countries, government authorities may take general public policy-related interests into account, rather than the particular details of a specific deal. Where that happens, national licensees should expect authorities to look at elements that would otherwise be left entirely for the parties to decide upon, such as the imposed price of the product based on the licensed technology or the choice of the technology itself to be licensed.

It is important to be familiar with these concepts. If a negotiator is able to identify such concept in a proposed contract, it can be rejected or its acceptance can be used as a leverage to obtain another benefit. The last alternative, however, raises two issues: one is that regulatory authorities may not be sympathetic to compensatory deals. Under the laws of certain countries, as noted above, a number of anti-competitive practices are deemed *per se* illegal, which means that, no matter the nature of the arrangement and eventual set-off compensation, such an arrangement is always illegal or unenforceable. For example, in many jurisdictions a contractual promise by the licensee not to challenge the validity of the licensed patent (or the licensed trademark) is unenforceable even though such a promise by the licensee gained the latter a lower price. Another example is a licensee's agreement to grant back to the licensor an exclusive, royalty-free license concerning any improvements made by the licensee.[9] The way governmental authorities see this sort of clause, as said, may vary, but negotiators should be aware that, in certain countries, these arrangements may be received with reluctance.

**Clauses in licensing agreements that are likely to be scrutinized by a competition agency.**[10]

**Article 4** of the Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 101(3) of the Treaty to categories of technology transfer agreements

9 EU Regulation n. 772/2004 on technology transfer agreements has now a more lenient approach towards grant backs. Although they are not automatically exempted from a competitive assessment whenever they concern severable improvements on an exclusive basis (article 5.1a), grant backs will be assessed on a case by case basis, considering the market position of the licensor and whether similar clauses exist for competing technologies

10 Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, European Commission Notice, OJ C101/2, 27 April 2004

**Agreements among competitors**

a) The restriction of a party's ability to determine its prices when selling products to third parties;
b) The limitation of output, **except** limitations on the output of contract products imposed on the licensee in a non-reciprocal agreement or imposed on only one of the licensees in a reciprocal agreement;
c) The allocation of markets or customers **except**:
i) the obligation on the licensee(s) to produce with the licensed technology only within one or more technical fields of use or one or more product markets;
ii) the obligation on the licensor and/or the licensee, in a non-reciprocal agreement, not to produce with the licensed technology within one or more technical fields of use or one or more product markets or one or more exclusive territories reserved for the other party;
iii) the obligation on the licensor not to license the technology to another licensee in a particular territory;
iv) the restriction, in a non-reciprocal agreement, of active and/or passive sales by the licensee and/or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party;
v) the restriction, in a non-reciprocal agreement, of active sales by the licensee into the exclusive territory or to the exclusive customer group allocated by the licensor to another licensee provided that the latter was not a competing undertaking of the licensor at the time of the conclusion of its own license;
vi) the obligation on the licensee to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products;
vii) the obligation on the licensee in a non-reciprocal agreement to produce the contract products only for a particular customer, where the license was granted in order to create an alternative source of supply for that customer;
d) The restriction of the licensee's ability to exploit its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development, unless such latter restriction is indispensable to prevent the disclosure of the licensed know-how to third parties.

**Agreements among non competitors**

a) the restriction of a party's ability to determine its prices when selling products to third parties, without prejudice to the possibility to impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;
b) the restriction of the territory into which, or of the customers to whom, the licensee may passively sell the contract products, **except**:
i) the restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor;
ii) the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licen-

sor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group;

iii) the obligation to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products;

iv) the obligation to produce the contract products only for a particular customer, where the license was granted in order to create an alternative source of supply for that customer;

v) the restriction of sales to end users by a licensee operating at the wholesale level of trade;

vi) the restriction of sales to unauthorized distributors by the members of a selective distribution system;

c) the restriction of active or passive sales to end users by a licensee which is a member of a selective distribution system and which operates at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorized place of establishment.

As most restrictions in a license agreement can be anti-competitive under certain circumstances, good practice suggests evaluating proposed restrictions in light of the facts, as they exist before entering into an agreement. The parties to the agreements, however, must recognize that the facts may change over time while the restriction in the agreement does not. If, for example, one or both parties of the licensed product achieve market dominance or market power that did not exist when the license agreement was entered into, restrictions that were not anti-competitive when originally adopted may become require a more detailed screening. Periodic re-consideration of restrictions in long-term license agreements is a good practice.

At the time of negotiating an IP license agreement, good practice suggests to examine the following restrictions or conditions in light of anti-competitive effects:

1) An exclusive license

a) In a defined geographic area that is smaller in scope than the licensee's usual area of business

b) In a defined field of use that is smaller in scope than the licensee's usual area of business

2) An exclusive cross license of IP rights

3) An agreement among IP owners that grants reciprocal IP rights to all parties to the agreement, but restricts the ability of each owner to grant rights under its own IP to third parties

4) An agreement in which the licensee agrees to assign or exclusively license back to the licensor all improvements made to the licensed technology

5) An agreement in which the licensee is compelled to accept a license under multiple IP rights, particularly where some of the licensed IP rights can be exploited without using other of the licensed IP rights

6) An agreement in which the licensee has no option and must purchase from the licensor or its agent additional products or services

7) An agreement in which the licensor of IP rights pays the licensee in addition to granting the license

8) An agreement in which the licensee agrees not to compete
9) An agreement in which any party agrees not to do business with certain third parties
10) An agreement in which the licensee agrees to pay royalties for products or services without regard to the relation between such products or services and the licensed IP rights
11) An agreement in which obligations or restrictions continue beyond the life of the licensed IP rights

None of the restrictions or conditions listed above is necessarily illegal *per se*. The list is intended to describe clauses that require further review under applicable competition laws.

Besides the purely legal aspect of those clauses, and regardless of whether there is a statute dealing with anti-competitive practices in a country, it is important to pay attention to their practical consequences. For example, if the licensee determines that the patent on which it has been paying royalties is invalid, the licensee may not wish to challenge the patent if the license provides some market exclusivity that has greater value than the royalties being paid.

Now, very briefly, let us see a few concrete examples of clauses that may raise concerns, even though there may be strong business justifications for them.

## 2.1. Subject matter

Several years ago, the governmental authorities of a number of developing countries would scrutinize international technology transfer agreements not only in regard of the commitments made by the parties, but also as to the subject matter itself (covered by the licensed intellectual property). The rationale of such an approach was the need for monitoring/limiting the transfer of foreign currency. Only contracts for the transfer of technologies that were deemed essential would be registered and, therefore, only those could generate legitimate payments in foreign currency.

This approach has been abandoned in general (with some exceptions), but depending on the nature of the technology, the treatment of licensing contracts can still be differentiated. For example, when the technology transferred falls under a national program of incentives (e.g., for national capacity building) it may be treated more favorably by governmental authorities.

Another important issue that concerns the subject matter of the contract is that the different IP rights involved in the negotiation should keep a direct relation with the objectives of the contract. For example, in a cross-licensing agreement, two or more parties may grant each other the rights to use one or more the patents each owns. This benefits competition by allowing each other to design technologies without provoking infringement. In some countries, the cross-licensed IP rights must relate to the same subject matter and other IP rights should be excluded.

When a patent owner licenses a technology, there may be a requirement to license more than one patent in order to commercialize the invention. Such license for the multiple patents is called a "package license". Such package license is generally considered enforceable when the parties willingly accept the package. However, if the licensor forces the licensee to license certain patents even if they are not required by the licensee, such license is called as "coercive package license" (which is, ultimately, a modality of tying). Even licensing of titles that do not require royalty payments (whenever the licensee undertakes to maintain those titles in force by paying maintenance and/or renewal fees, exploiting them, defending them against infringers, etc) is not necessarily a bad deal, but it can be considered as coercive package license if the licensee is required to license undesired patents. The reason is that, in order to use those additional titles, the licensee may need to adapt its production methods and fall completely under the licensor's technological control. Also, if the unwanted patents have a longer life, the terms of the license agreement may be extended thereby imposing on the licensee obligations or restrictions for an extended term.

## 2.2. Scope of the license

In general, negotiators should envisage commitments that are necessary for reaching the objectives they share. In that context, the licensee should negotiate a balanced scope of the license that corresponds to the business objective of the licensee. Less commitments than necessary would make the contract ineffective, and thus become a potential subject of future disagreements. More commitments than necessary (on both sides) make the agreement costly, likely ineffective and almost invariably a source of dispute and litigation.

A few examples are indicated below:

For example, the licensee should not be obliged to transfer or grant back to the licensor (or to another company designated by the latter) improvements introduced by the licensee under conditions that are different (i.e. less advantageous) than the contract conditions. Improvements may be defined differently depending on the IPR subject matter. In general, improvements of patents and improvements of copyrights receive a different legal protection. For instance, often a creator enjoys an exclusive right to prepare derivative works based on the copyrighted work, whereas a new and separate patent may be issued for an improvement to an invention.

### Improvements

When dealing with improvements, also known as versions, enhancements, and new models, it is important to define what is an improvement and, therefore, covered by the license, and what is a new technology or new intellectual property. In the latter case, depending on the national law, a new license agreement may be required. Improvements to the licensed technology are not likely to be a major issue where the licensor is in successful commercial production. Where, however, the licensor and/or the licensee is involved

in ongoing research and development, or the licensed technology is at an early stage of development, it is likely that improvements will be made to the process or product during the term of the license agreement.[11]

Many licensees are keen to improve on the licensed technology, particularly when they result from necessary adaptations to the physical environment of the production. The licensor may be very interested in learning (and be licensed) of those adaptations, so that he can more successfully license it to others.

If the patent license is paid, the legal obligation of granting back all improvements on an exclusive or royalty-free basis might not be regarded as pro competitive. In fact, until recently, exclusive and unilateral "grant backs" imposed by licensor on licensee were explicitly forbidden by EU competition law, and as such were the basis for invalidating a licensing contract as a whole. It may be acceptable to have a clause whereby the transfer of improvements is reciprocal and under the same conditions for both parties. It should be noted that grant back tends to have a positive impact on innovation to the extent that it adds to the level of technical sophistication of the innovation and contributes to the dissemination of knowledge about the licensed technology that is generally the result of adaptations to local conditions by the licensee. These adaptations may then be shared by the licensor with other licensees.

In the absence of particular circumstances or offsetting compensation, restrictions as to certain activities by the licensee are also to be avoided. Such restrictions might include the obligation of the licensee not to acquire, research and/or use competing technologies or products ("exclusive dealing"); the obligation of the licensee to select and recruit personnel other than the one designated by the licensor; the obligation of the licensee to acquire technologies and products from a particular third party ("third-line forcing"); the commitment not to sell products resulting from the use of the transferred technology in certain regions of the country or abroad.

Finally, one additional example is presented here: the agreement may contain certain clauses that may give the licensor a certain power of interference in the technical management of the company being to which a license is granted. However, such interference should never go beyond what is strictly necessary to ensure that the transfer of knowledge goes smoothly and enables the licensee not only to effectively absorb it, but also to put it fully in practice. In a number of licensing agreements, the licensor gives assurance that the technology transferred will allow the licensee's production to reach certain levels of output (in terms of quantity, quality, costs, energy saving, etc), and with that in mind the licensor may wish to ensure that the administrative structure of the licensee will not impair that goal to be achieved. Such arrangements (and in particular know-how transfer) may have an effect on the royalty payment structure

11 WIPO/ITC, "Exchanging Value", 2005

(see example below). For example, the licensor may need to ensure that stocks are managed by the licensee in an adequate manner, or that the circulation of raw materials and product ingredients within the licensed company is rapid, technically sound and waste-free. As in all other cases, the licensor and the licensee should have sound business reasons to ensure that such clauses are justifiable.

### Royalties[12]

a) In consideration of the License hereby granted and of the Know-How and the technical assistance provided for in Article XX and subject to the remaining provisions of this Article, Licensee shall pay royalties in accordance with the following schedule on the worldwide Gross Sales of Products covered by issued patent claims of Patent Rights during each Sales Year commencing with the second Sales Year (…)

## 2.3. Financial terms

The parties are in general free to set any financial conditions, taking into account other negotiated terms of the agreement. Intellectual property rights are considered private rights and in such a context, governments are, generally speaking, not supposed to impose limits on royalties and other financial considerations. However, as noted above, government authorities may take public policy-oriented measures that end up having an impact on the financial terms of licensing agreements, such as fiscal policies and subsidized credit mechanisms.

Under specific circumstances, an IPR holder may be considered as the owner of an essential facility and therefore be subject to the scrutiny of competition agencies. The IPR holder's decision not to provide a license may be considered as anti-competitive and the IP subject to compulsory licensing.[13] This is particularly true where the IP rights are essential to the practice of an adopted standard for commercialization of a product. If the IP rights owner participated in the standard setting, it is obligated to grant licenses to such IP rights under reasonable and non-discriminatory (RAND) terms.

12 WIPO/ITC, "Exchanging Value", 2005, p.57: "… the royalty base could be either the gross or the net sales receipts of the licensee. Gross receipts do not allow for deductions for such expenditures as packaging and freight".

13 In general competition authorities' decisions on compulsory licensing do not enter into contractual conditions that probably would go beyond their responsibilities. The decision to impose an obligation to license to a dominant firm that abused its power is the result of an investigation on an antitrust violation consisting typically of a refusal to deal: this requires a very high standard of proof (see for instance the European case on IMS Health, Case C-481/01, IMS Health GmbH & Co OHG v. NDC Health GmbH & Co KG, 2004 ECR I-5039, or the US case concerning the acquisition of Immunex Corp. By Amgen Inc. – see *www.ftc.gov/opa/2002/07/amgen.shtm*) However, it may happen that in countries where competition law is enforced directly by the government, there may be instances where other government branches may play a role in enforcing the decision, e.g. by specifying certain contractual conditions.

### Compulsory licensing

In addition to required licensing of IP rights essential to adopted standards and to compulsory licensing as a remedy for anticompetitive behavior, compulsory licensing may be the result of direct government or judicial intervention also as part of the exceptions under the TRIPS agreement in cases that involve public interest and, in many countries, lack of working (also known as patent suppression). When the compulsory licenses aim at addressing national emergencies, urgency or public non-commercial use, certain mandatory requirements for granting a compulsory license are waived.

Setting the amount of royalties is an area where the asymmetry of information between the licensor and the licensee is the greatest. However, this is not a matter of competition law, even when they are set at a very high level. To charge prices as high as possible is within the prerogatives of the IP owner, except if those prices are regulated or, where the parties are in a vertical relation, the licensor sets royalties at different levels for different licensees that put some of them at a competitive disadvantage with no sound business justification.

One aspect that negotiators should take into account, however, is that an obligation of the licensee to pay royalties based upon the use of an expired patent (at the end of its term or by reasons of abandonment, lapse or invalidation) is never acceptable. This, of course, does not refer to royalties based upon the use of the patented invention during the term of validity, but collected after the expiry. Moreover, certain obligations on both sides may survive the termination of the rights, such as keeping secret certain information received, or continuing to supply improvements introduced by the licensor, but never an obligation to pay.

## 2.4. Jurisdiction and applicable law

The choice of law as well as of jurisdiction may be a topic of negotiations as well as of scrutiny by authorities in charge of analyzing licensing agreements, but in general they do not give rise to anti-competitive concerns, unless such a choice is made in a manner which it would constitute an unreasonable restraint against one of the parties.

Applicable Law – Mediation and Arbitration
Dispute resolution and applicable law
Mediation Followed, in the Absence of a Settlement, by Expedited Arbitration

"Any dispute, controversy or claim arising under, out of or relating to this contract and any subsequent amendments of this contract, including, without limitation, its formation, validity, binding effect, interpretation, performance, breach or termination, as well as non-contractual claims, shall be submitted to mediation in accordance with the WIPO Mediation Rules. The place of mediation shall be [specify place]. The language to be used in the mediation shall be [specify language].

If, and to the extent that, any such dispute, controversy or claim has not been settled pursuant to the mediation within 60 days of the commencement of the mediation, it shall, upon the filing of a Request for Arbitration by either party, be referred to and finally determined by arbitration in accordance with the WIPO Expedited Arbitration Rules. Alternatively, if, before the expiration of the said period of 60 days, either party fails to participate or to continue to participate in the mediation, the dispute, controversy or claim shall, upon the filing of a Request for Arbitration by the other party, be referred to and finally determined by arbitration in accordance with the WIPO Expedited Arbitration Rules. The arbitral tribunal shall consist of a sole arbitrator.* The place of arbitration shall be [specify place]. The language to be used in the arbitral proceedings shall be [specify language]. The dispute, controversy or claim referred to arbitration shall be decided in accordance with the law of [specify jurisdiction]." (* The WIPO Expedited Arbitration Rules provide that the arbitral tribunal shall consist of a sole arbitrator.)

## 3. Final remarks

In conclusion, as negotiators representing the interests of prospective licensees and licensors, three key elements should be kept in mind:

– The agreement should fully take into account the interests of the negotiating parties and be reasonable, balanced and fair, including as regards the financial terms, the value of the technology and the forms of payment; this means that the contributions of both parties should not be disproportionate in terms of financial payments as well as other commitments vis-à-vis the value of the technology;

– Throughout the negotiations, the parties should consider the future impact of certain restrictive commitments (such as restrictions on exports; restrictions or impositions on pricing; the obligation to use associated technologies – or brands, in the case of trademark licensing; etc);

– Each party should be aware of the regulatory environment in every country in which the agreement will have an impact and should understand that in certain countries, government agencies (the intellectual property office or the competition agency) are not only empowered with the task of monitoring licensing agreements as a condition of their approval (for the purpose of permitting the remittance of payments in foreign currencies abroad or securing certain tax benefits, when the importation of the technology in question is covered by government incentives), but also with the authority to scrutinize the potential anti-competitive effects of certain agreements and clauses.[14]

14 In this regard, it is of the essence for the creation of a business environment of confidence and legal security, that competition law and related policies are applied by national authorities on a non-discriminatory basis both for national and foreign parties.

# VI. Using the Signed Agreement

Once you have signed the agreement, have a celebration with the other side because you are starting a business relationship. **The agreement is only the beginning.** Do not put the agreement in a locked file and throw away the key. The agreement is an important guide to what should happen in a complex, technology-based business relationship. In non-technology agreements, the terms may be simple and memorable (e.g. I will pay you $5 a widget). However, technology licenses and corollary agreements are generally more complex and often impose important conditions, the violation of which can create legal liability and business mistrust.

All executives and managers who work with the other party should be aware of the license and its terms. For example, if you have agreed to license in a piece of software and you do not have the right to modify it, make sure that the engineers who work with the software know this. If you have a patent license to a medical invention and you are not permitted to sub-license the rights to the patent, make sure that business development personnel know this and do not violate this provision unknowingly.

Agreements often have important dates that must be recalled. For example, if one party has agreed to invest in the other based on the attainment of certain milestones, or if warrants can be issued by a certain date, these dates must be tracked. It is also important for someone in the enterprise to keep track of deadlines for delivery of technology prototypes, software, documentation, and so forth, as well as deadlines for research and development of IP enhancements. Finally, technology licensing generally involves payment of recurring royalties. If you are the licensor, you will need a system to keep track of payments and monitor royalty recovery. There are businesses that specialize in providing this service if you are not equipped to do so. If you are the licensee, you will need to keep track of royalties due and maintain adequate documentation.

There are other key terms that require on-going attention and reference to the agreement after the signing of the agreement. It is advisable to review the agreement and identify such terms and assign responsibility for tracking each one.

Finally, the agreement will usually have a termination, expiration, or renewal date. You will want to refer to the agreement at that time to see what key terms have been advantageous and which should be revised if you will be renewing the license.

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**Note that this document is not intended as a substitute for legal advice. It is essential in any technology licensing negotiation to retain legal counsel. This list will familiarize you with the issues so that you can communicate effectively with your legal counsel.**

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# Appendix I & II

# Appendix I
# Sample Internal Term Sheet

**This term sheet is to facilitate discussion only and is not intended to be legally binding on either party. A party may withdraw from negotiation at any time upon notice to other party. Any agreement between the parties is subject to negotiation and execution of an appropriate,definitive contract document that is approved by the senior management and/or board of directors of each party and signed by officers of both parties.**

Name of potential licensor (or licensee) and contact info:

Name of team members and contact info:

Technology to be used in (name of product and/or product line):

Important dates and deadlines (e.g. manufacturing start, press release. Has development, manufacturing, or distribution already commenced in advance of the agreement?):

1. Subject matter (use specification, technical description, patent numbers, name of a work, trademark, etc. Are any standards applicable?):

2. Ownership (check ownership):

3. Related agreements (development, consulting, training, purchase, investment, service, etc.):

4. Development (Is the technology completed? Is it fully functional? If not, who will complete development, do further research, do prototypes, correct design flaws, etc.?):

5. Scope of license (What rights are being licensed? Non-exclusive or exclusive? Make, use, sell, make copies? Distribute?):

6. Derivative works, improvements (Will licensee have right to change the technology or make new products based on the technology.):

7. Sub-licensing (Will licensee have right to sub-license? If so, what rights will sub-licensees get?):

8. Geographic territory (Where can the licensee use the license?):

9. Field of Use (Are technical fields limited?):

10. Financial (What fees are to be paid to licensor? What royalties? Other payments? Any warrants, stock? Any minimums on royalties? Any caps on royalties? Advances by licensee? How to pay back advances?):

11. Term (For how long will the agreement last? (term of agreement). Does this depend on events?):

12. Future versions (Is there an agreement on license rights to future versions of the technology? Related products?):

13. Obligations (What obligations should the parties have other than the license? (e.g. testing, marketing, clinical trials, meeting standards, etc.)):

14. Disputes (Where settled? Who indemnifies against risk from 3rd party claims?):

# Appendix II
# Examples of clauses that have potential anti-competitive impact

## 1. Definition of confidentiality and obligations (patented technology licensing).

EXAMPLE: Confidentiality Obligations. The Parties agree that, for the term of this Agreement and for ten (10) years thereafter, either Party that receives Confidential Information (a "Receiving Party") from the other Party (a "Disclosing Party") shall keep completely confidential and shall not publish or otherwise disclose and shall not use for any purpose (except as expressly permitted hereunder) any Confidential Information furnished to it by the "Disclosing Party" pursuant to this Agreement (including without limitation, know-how), except to the extent that it can be established by the Receiving Party that such Confidential Information: (a) was already known to the Receiving Party, other than under an obligation of confidentiality from the Disclosing Party;(b) was generally available to the public or otherwise part of the public domain at the time of its disclosure to the Receiving Party; (c) became generally available to the public or otherwise part of the public domain after its disclosure and other than through any act or omission of the Receiving Party in breach of this Agreement; (d) was subsequently lawfully disclosed to the Receiving Party by a Third Party; (e) can be shown by written records to have been independently developed by the Receiving Party without reference to the Confidential Information received from the Disclosing Party and without breach of any of the provisions of this Agreement; or (f) the disclosing party has specifically agreed in writing that the Receiving Party may disclose.

*QUESTION: Is it acceptable that the Licensor imposes restrictions on the use of confidential information after the expiry of the Agreement? If yes, for how long? Would indefinite duration of confidentiality be acceptable (until one of the forms of disclosure above listed takes place)?*

*ANSWER: The conditions concerning confidentiality obligations are very much industry-related. It is not unusual that such obligations continue indefinitely until one of the conditions a) to e) are met, although in a fast paced sector where scientific and technological development occurs very quickly that confidential information may become obsolete anyway. In general, though, one should avoid an indefinite confidentiality obligation as it may unduly limit the further development of technologies in the specific market and therefore limit competition*

## 2. Limitations concerning the use of the licensed patented invention imposed on the licensee

The Licensor hereby grants the Licensee a non-exclusive license, without any right to sublicense, under the Licensed Patents in the Field but only in Direct Support of the Licensee's internal and collaborative research and development activities. As

used herein, "Direct Support" means that the Licensee may operate under the Licensed Patents to identify compounds with activity against targets that have been selected through the Licensee's internal research and development programs or to identify compounds for which the Licensee will pay for a share of the development costs or receives at least a 10% royalty (or equivalent revenue share) or has any rights of commercialization. In accordance with the foregoing, it is acknowledged and understood that the Licensee is not permitted under the license granted herein to compete with the Licensor by providing combinatorial chemistry services to third parties on a fee-for-service basis.

Limitations on License Grant. Except as permitted under this Section, the Licensee may not operate under the Licensed Patents on behalf of any Third Parties such as, for example, in connection with providing research or development services to any Third Party on a contractual basis. The foregoing license grant is further limited to on-site activities at one or more actual Licensee's Sites, and does not include or permit off-site or remote access through the internet or otherwise.

*QUESTION: Are these two restrictions on the Licensee's future commercial and research activities acceptable? Should they be acceptable if they were time-limited?*

*ANSWER: One element to be taken into consideration is whether the parties are competitors or not. In case they are competitors, there is a risk that such clauses may be interpreted as collusion aiming at technology foreclosure. The extent that such an agreement will fall under antitrust scrutiny depends on the parties market shares and some jurisdictions have determined a threshold under which the agreement does not pose any threat to competition. In case the parties are not direct competitors, the risk of antitrust scrutiny is much lower and higher market share thresholds are likely to apply.*

## 3. Patent maintenance and infringement

The Licensor shall prepare, file, prosecute and maintain the Licensed Patents at the Licensor's expense and in a manner deemed appropriate in the Licensor's sole judgment. The Licensor agrees to keep the Licensee fully advised of the status of all Licensed Patents, upon reasonable written request from the Licensee.

*An alternative approach, in certain contracts, is to make the Licensee responsible for maintaining the licensed patent(s) in the territory (ies) it operates, notably by timely paying the maintenance fees.*

*QUESTION: Do you think this would be acceptable?*

*ANSWER: It is customary that the licensee is required to pay all costs in connections to a patent as well as to cover the expenses for patent maintenance. While this is of course a matter for the parties to agree upon, the specific arrangement is unlikely to raise a competitive concern.*

In the event that the Licensee becomes aware of any infringement by Third Parties of any of the Licensed Patents, subject to any confidentiality obligations the Licensee may have, the Licensee shall promptly notify the Licensor. The Licensor shall respond to any such infringement by Third Parties in a manner deemed appropriate by the Licensor in its sole judgment.

*The Licensee should be ready to establish some mechanism that ensures that the Licensor is diligent in defending the licensed patent(s), otherwise the Licensee himself should be empowered to do that and any costs will be borne by the Licensor. You should not forget that infringement by third parties may reduce the economic value of the License you are paying for.*

Third Party Patent Rights. If any warning letter or other notice of infringement is received by a Party, or action, suit or proceeding is brought against a Party alleging infringement of a patent of any Third Party with respect to operations under the Licensed Patents, the Parties shall promptly discuss and decide the best way to respond.

*QUESTION: Would you agree that the Licensee should respond in the event the Licensed Technology infringes third parties' rights?*

*ANSWER: In principle it should be the licensor that takes responsibility for defending its patented rights, unless the alleged infringement is somehow the result of an obvious licensee's misconduct.*

## 4. Right to use trademarks upon termination of the contract (trademarks associated with goods covered by the licensed patents)

Upon termination of this Agreement with respect to any country in the Territory or deletion of such country from the Territory as provided herein prior to the expiration of the full term set forth in Section […] below, the Licensee will immediately cease all use of the Licensed Marks in any such country other than the sale or other disposition of Licensee's inventory of the Licensed Products, and, in such event, the Licensee shall not thereafter adopt or use the Licensed Marks or any confusingly similar words or mark without the Licensor's prior written consent. If the Licensee is then using marks other than the Licensed Marks, the Licensee shall transfer all of the Licensee's right title and interest in and to such marks in such country to the Licensor; provided however, that the Licensee shall not be required to transfer any right, title or interest in any mark which is also used by the Licensee with products sold by the Licensee other than the Licensed Products. In addition to the above obligations, upon termination of this Agreement with respect to any country in the territory wherein the Licensee has registered a Licensed Mark or deletion of such country from the Territory as provided herein prior to the expiration of the full term set forth in Section […] below, the Licensee shall transfer all Licensee's right title and interest in and to such Licensed Mark in such country to the Licensor.

*The problem is in this sentence: "If the Licensee is then using marks other than the Licensed Marks, the Licensee shall transfer all of the Licensee's right title and interest in and to such marks in such country to the Licensor." as well as in this: "In addition to the above obligations, upon termination of this Agreement with respect to any country in the territory wherein the Licensee has registered a Licensed Mark or deletion of such country from the Territory as provided herein prior to the expiration of the full term set forth in Section […] below, the Licensee shall transfer all Licensee's right title and interest in and to such Licensed Mark in such country to the Licensor." It results from this clause that when the contract expires, the Licensee shall no longer be authorized to sell the Licensed Products (except until the complete sale of inventory). Nevertheless, its own trademarks may have a value in themselves. Their respective goodwill has been established by the Licensee's own efforts. It seems, therefore, that the Licensee should be entitled to be paid for the transfer of those marks. Otherwise, he should retain the title to those marks and eventually benefit from the good-will they represent (for example, by using them to identify different goods).*

## 5. Restrictions on use

This refers to a temporary license of a patent. In fact, even if the common practice is to license patents for the duration of their terms, there are cases in which a licensee may be interested in a temporary deal – for the making of a seasonal product, for example, such as certain vaccines, or for testing the predisposition of consumers to a new technology.

Notwithstanding anything to the contrary in this Agreement, the Licensor reserves the right to make and use the Licensed Product in its own facility for its own use (not for resale) in all fields of use (including, without limitation, the Exclusive Field of Use), and to purchase the Licensed Product for use and sale in all fields of use from the Licensee under terms and conditions described in Article […] with the exception that the Licensor agrees not to sell the Licensed Product to any Third Party who the Licensor knows is a competitor to the Licensee as listed, but not limited to, in Appendix […] and not to sell the Licensed Products to any Third Party already buying the Licensed Products from the Licensee or already in contact with the Licensee related to the Licensed Product.

The Licensor hereby reserves all rights in and to the Licensor's Intellectual Property not expressly granted to the Licensee hereunder, including, without limitation, the right to make, have made, use, sell, offer to sell, import and export the Licensed Product outside the Exclusive Field of Use, with the exception that the Licensor agrees not to sell the Licensed Product to any Third Party who the Licensor knows is

a competitor to the Licensee as listed, but not limited to, in Appendix […] and intends to distribute the Licensed Product for use in the Non-Exclusive Field of Use without modification, without incorporation into said party's own products or packaged application kits, or without related services or other value added form that is differentiated from the Licensee's commercial offering of the Licensed Product.

*This is a clause that implies a refusal to deal – the Licensor promises to refuse to sell the licensed products to the Licensee's competitors. Note: the Licensor is not promising to refuse to license the technology to the Licensee's competitors, but to sell them the products incorporating that technology. Ultimately, the Licensor is promising that there will be no price competition, thereby guaranteeing a higher price for the Licensee. This seems to be within the exclusive right of the Licensor. QUESTION: How do you think a national authority would see this clause?*

*ANSWER: What is important in this case is the position of the licensor (and possibly the licensee) in the relevant market and whether the licensing is exclusive or sole and between competitors or non-competitors. Typically if the licensing is exclusive, reciprocal and between competitors then it is considered a hardcore competition restriction. In all other cases a competitive concern may arise if market shares are high (or beyond a certain threshold), if the territory concerned by the license is worldwide and whether an exclusive license may be necessary to encourage the licensee to invest in the licensed technology to ensure eventual product marketing.*

## 6. Royalties

i) The Licensee agrees to pay the Licensor a Royalty of five (5%) percent of Net Sales Revenue on all Licensed Product it manufactures, sells and distributes. The Licensee agrees to pay this royalty on all Licensed Products sold in the Territory, including those sold where patent protection does not exist.

*QUESTION: Do you think the clause "including those sold where patent protection does not exist" is acceptable?*

*ANSWER: There are several instances where royalties may be paid also for products whose intellectual property is not covered by a patent (in fact the royalty may be split between patented and non-patented components of the licensed product), for instance to pay for trade secrets, know-how or technical knowledge which is complementary to product manufacturing/marketing.*

ii) Licensee agrees to pay the Licensor a royalty of fifty (50%) percent of all revenue generated from sublicenses.

iii) Licensee agrees to pay the Licensor ten (10%) percent of all revenue generated by the sale of advertising, sponsorships, games, and promotions to be used on the Licensed Product.

*QUESTION: Would you agree that this clause is beyond the scope of the patent rights? Would you accept to pay an extra amount of royalties for efforts, such as advertisement, that have nothing to do*

*with the use of the licensed technology? ANSWER: In general royalties should be paid on total sales, irrespective of whether they are made through the licensee or through sub-licensee. There should not be any difference in royalties based on the actual subject that is marketing the licensed product(s). As for sharing the cost of activities unrelated to the licensed technology, it is of course up to the parties to decide, but it may be advisable to avoid it as it refers to expenses that are outside the licensee's control and whose impact on the licensed product(s) may be unclear.*

iv) Licensee agrees to pay the Licensor minimum guarantee each year of the contract period as follows:

June 1, 2009 $50,000

Year 1
$100,000

Year 2
$150,000

Year 3
$200,000

Year 4
$250,000

Year 5
$350,000

Payment of the Year 1 guarantee will take place no later than January 31, 2010. Following year guarantees shall be payable in four quarterly installments. All guarantees are recoupable against royalties earned during the year.

v) Royalties are due and payable within 30 days of the end of each quarter.

vi) All payments to be made in U.S. Dollars.

Buyout. The Parties understand and agree that the Licensed Product may draw the interest of a major leader in the beverage industry. In the event that such a company is interested in a buyout of the Licensed Technology, the Licensee shall be entitled to 25% of revenue generated by the sale of the Licensed Technology.

*QUESTION: Would you accept, if you were negotiating for the Licensee, anything under 50%? Please note that the Licensor, as set above, is entitled to 50% of royalties obtained from sublicenses.*

*ANSWER: If the 50% clause remains (as discussed above that may be questionable), then the licensee should not agree to receive less than 50% in order to receive some benefits from third party's sub-licensing.*

For more information
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