

AGREEMENT (LICENSES) Q AND A (10/36)

The Q&A herein are excerpts from "Technology Commercialization Manual. Strategy, Tactics, and Economics for Business Success." (www.tclearningcenter.com). Notation after each heading reflects the (# of excerpts/total Q&A).

The Q&A are for information only. Seek legal or accounting advice for specific situations.

1. Should one allow a license to be assigned or serve as collateral? A license was granted to a spin-off company, who is negotiating a loan to finance commercialization of the licensed intellectual property. The licensee's lender is asking for consent by the licensor to allow the lender to reassign the license to a company of its choice in the event that the lender forecloses on the loan. The lender says it won't make the loan without obtaining the consent. Without the loan, the company will likely fold. Should the licensor grant its consent?

Relaxing diligent control over "ownership" of one's intellectual property in order to help finance its development is not recommended. It's best to keep control of the ownership of intellectual property. If the lender, upon foreclosure, has a new "licensee" in mind they can ask one to agree to the transaction. Often a licensee will want language allowing the license to be assigned or transferred to a company that acquires a controlling interest in the licensee. If the licensee is solely in the business of developing the intellectual property in question, then the lender's remedy upon foreclosure is to take control of the company and, with it, the technology. If the lender then wants to assign the intellectual property to a new company the new company would have to acquire the failed company. While this presents issues ie. asset purchases vs. equity purchases, these are not the licensor's concern.

Mortgaging real property is one thing but intellectual property is not the same. In the past licenses were granted to a known licensee who sometimes had sublicensing rights, with approval of licensor, and some recursion rights if licensee defaulted or went bankrupt. Allowing a lender to assign the license to another entity of its exclusive choice, is foolhardy, considering the games played in today's volatile markets. It is better to sell the intellectual property to the spinoff, unless the licensor has other needs for continued ownership, and is positioned to pay maintenance fees and annuities. If one wants to retain control, and not have the intellectual property fall into hands adversarial to other potential licensees, then consider reassignment rights only after review of the new assignee, when known. It may be good business to grant a license to the new party, but not by way of a lender who will most likely treat the intellectual property as a book asset and not in the original licensor's interest!

The problem with assignment to a lender is that one will lose control of their intellectual property if the licensee defaults on the loan. However, if the licensee is facing a do or die situation, one should not unreasonably withhold agreement but try to add terms to the license that will not create a problem in the event of reassignment. For example, the assignee would have to assume all financial and non-financial covenants as they are, as licensor have a right to approve the assignee which approval will not be unreasonably withheld, and the assignee must pay any license payments in default. In addition, if the licensor has taken equity in the original licensee in lieu of cash payments, ask for certain "assumption fees" to compensate one for their loss.

A lender who is neither motivated nor equipped to develop the intellectual property or find a quality licensee, and for whom the intellectual property has more value as a tax loss than as a "going business".

Where there is valuable intellectual property involved consider registering one's interest under Personal Property Security Act legislation so you are the first creditor; not the last creditor.

2. What role should an academic institution play in current negotiations to minimize problems that may occur later and in the event a small company fails? Is there a standard approach to such a scenario? In this case the question is what role an academic organization needs to play in a sublicense. The third party client wants to license technology exclusively licensed to a small company by the academic institution - the license includes sublicense rights. Some payments on the license have been made, but there is concern that the small company may default on the license, at which time there would be a need to renegotiate directly with the academic institution.

Sublicensing has always been and still is an area of conflict. If a licensee makes a substantial return by sublicensing a technology either the licensee has added substantial value or the original licensor has mispriced the technology in the initial license agreement. When the university licenses a technology the university/licensee in free competition set the value and reach agreement. In a freely competitive market this is how price and value is established. Once the price is set in the license why should the original seller (i.e. the university) obtain any future value? Normally once any product is sold the initial seller obtains no further value if the buyer resells the product-whether the price goes up or down. Certainly if the value of the university technology goes down (the most common situation) the university doesn't give back to the licensee any of the initial price-does the university that prices the original sale to the licensee at full market value deserve an additional upside from sublicensing which is without risk - no downside. Probably not, so if the technology was priced correctly in the initial license then the increase in value was added by the licensee and they deserve the reward.

3. How can the university ensure that it gets part of this subsequent "sublicense" deal. What are the different mechanisms? For instance the university could ask for a percentage of "sublicense license milestone payments". What are the different types of milestone payments? What happens when payments to the biotech co. by the pharma co. are in the form of equity - can the university get a % of these payments?

The role played by the University will depend on whether the terms of the license granted to the small company (licensee) permit the University to control the terms of any sub-license. The University may, for example, be concerned with the dilution of royalties from revenues arising from the technology as a result of the sub-license (e.g. if the University is to receive say 3% of net revenue from the technology, it will want to ensure that this 3% is not diluted to 3% of 3% of royalties paid by the sub-licensee to the licensee).

In a transaction involving a sublicensee, consider a tripartite licensing agreement to be executed by the University, the licensee and the sub-licensee. In the event of the licensee's insolvency, or termination of the license by the University due to the default of the licensee, the University stands in the place of the licensee vis a vis the sub-licensee, with all other provisions remaining intact. This will depend on the University's willingness to their enjoyment to the agreement between the licensee and the sub-licensee.

Regarding royalties to be paid by sublicensees determine the sub-licensee's contribution to the process. Basically, the same royalty rate that applies to a licensee should apply to a sublicensee. The more they add value, the more they should get to keep for themselves. If they are just passing on the licensing rights, then get the full amount received, and no less than what you would get if you were licensing this party directly (i.e., if you get 5% of your licensee's gross sales, you should get the same 5% of the sub-licensee's gross sales). Remember to also consider the licensing fees and other non-royalty amounts; otherwise, a licensee might think these fees belong to them. Seek at least half, or more, of such fees, depending on the relative contribution of the parties to the transaction. Furthermore, consider non-monetary transactions, e.g., a situation in which the licensee grants a sublicense to company X. Company X, in turn, provides the licensee with 10,000 hours of free consultation for the next year. Place a fair market value on these kind of transactions, what it would have cost to purchase them, and get a share.

As in any license, sublicensing terms are determined by negotiation. A range of 30-50% of sublicensing revenue is usually acceptable. Be careful how sublicensing revenue is defined. It should include all cash and non cash items not earmarked for specific purposes that are part of the sublicense transaction, especially equity investments in the licensee by the sublicensee.

Payments for equity investments by a sublicensee can be included in the definition of sublicensing revenue. Doing so would include them in the calculation for the percentage of sublicensing revenue that the licensee pays the licensor.

Avoid creating a disincentive for investment. If an investor knows that 50% of the cash will be going to the licensor, they may not invest.

These types of deals are common in the biotechnology industry. Investment by big pharma to biotechnology companies is usually done as a "cost of doing business." It also provides a validation of the biotechnology company and may help them attract investors for a new round of financing.

As a minimum require either a copy of the sublicense agreement, or a copy of the appropriate portion of the sublicense agreement, or sales reports and rights to audit, or a combination. Be aware of the Securities and Exchange statutes and liability concerns if a licensor provides too much input on how licensee runs their business.

4. University tech transfer office is trying to negotiate a licensing deal with a Japanese electronics company. The patents involved are mostly incremental improvements for which the company owns much of the background IP. The company appears to have cross-licensing arrangements with many of its main competitors, under which they have royalty-free access to each other's patents. They do not want a royalty-bearing licensing arrangement, but have offered a modest one-off payment for an exclusive license to each patent. They have said that the administrative burden of a royalty-bearing license would be too great for them, stating the main difficulties as: assessing the value of early-stage IP; assessing an appropriate royalty; identifying which products use a particular patent; calculating the total royalty in such a large company etc. Presumably it would also be difficult for them to pass on any royalty obligations to their cross-licensees. How should one structure a licensing deal with this type of company since a one-off payment doesn't seem fair?

Their points are consistent with the positions many US electronics companies take. Since they are cross licensing their own patents with competitors, there is really no-exclusivity in this business. Take the one-time payment but make the license non-exclusive. Since the company is offering the one-off in lieu of a royalty stream due to their burdens, presume a discount rate in line with the weighted average cost of capital of the technology transfer office rather than the WACC of the company. Presumably the technology transfer office cost of capital will be lower, allowing for a lower discount rate and yielding a higher NPV. Cash is nice and risk is gone, the day the check arrives.

An alternative approach is to place specific language in the agreement that clearly prohibits them from sublicensing and makes them positively assert that they agree that the license cannot be included in any cross-licensing agreements. There may be a complaint that their cross licensing agreements require that they get the right to sublicense their cross-licensees. Tell them that the price would be several times higher if they wanted such a right. This opens the door for you to ask for a copy of their cross licensing agreement. If they provide it, it normally is an interesting read. However, such a clause is rare in cross-licensing agreements and often one sees a clause that requires a cross-licensing party to extend to the others any rights which it has to a patent. If they don't have the right to sublicense, they can't extend that right. Tell them it puts their competitors on the same footing as them, since such competitors will need to pay for a license from you, rather than ride on the first licensee's coat tails.

5. Will a federal agency disclose the royalty a corporation pays for product sold that is subject to a license with the agency?

Usually not. The NIH recently won a lawsuit in which it was ruled that royalty amounts need not be disclosed.

Background: In July 2000, Public Citizen Health Research Group filed a Freedom of Information Act (FOIA) lawsuit against the NIH seeking royalty figures (including percentage of sale royalties) identifiable by company for each license the NIH Office of Technology Transfer executed from 1986-1998. Historically, NIH has taken the position that such information is protected from release under the confidential commercial/financial provisions of Exemption 4 of the FOIA.

Opinion: On March 12, 2002, Judge Colleen Kollar-Kotelly, United States District Court Judge, granted NIH's Motion for Summary Judgment and denied Public Citizen's Motion for Summary Judgment. The Court concluded that the NIH appropriately withheld the royalty information pursuant to Exemptions 3 and 4 of the FOIA. Public Citizen did not appeal the decision.

6. An IT unit in the organization has developed some software which probably has limited commercial potential in terms of licensing. However, they happened to come up with a very good name for the software and proceeded to get a decent amount of publicity for their work and the mark. A registration request has been filed. Several software companies who develop similar software are interested in licensing the mark for use with their product lines. Is there any advise you might give? What kind of royalties on products and services associated with the mark are customary?

Most of the product's value is in the trademark. The trademark provides market "branding"; provided that a market develops, and that market development sets the TM value in time. That is, for Gatorade, the TM provided the market branding strategy, so that when the patent ran out, the university could still claim on royalty on the TM based on brand reorganization. The Gatorade TM only had value because a market had developed and the product was worth something.

Thus, the royalty should be on the software plus TM, but the value is in the software, until, and if ever, the TM ever creates a branded value. It might be a mistake to think all the value is in the TM. There are a lot of "cool" TM names, but cool names don't make it unless the product makes it. A 15% royalty for both the software royalty plus TM might be reasonable.

Enact a "hybrid" license with two grants in the license agreement, with a specific amount of compensation for each part of the intellectual property package spelled out as what percentage of royalty you may be due. But Trademark and Copyright rights last much longer than patents. So the royalties can be paid for a very long period of time. On the other hand, Trademark licensing carries with it certain liability for the licensor. Defects in the software that may turn up from time to time can be attributed to the licensor's negligence in policing its trademark (this was the case in the consumer lawsuit against Levi Strauss). Indeed the trademark licensor has a duty to periodically check the quality of the products that it lends its trademark to. For software that is not hard to do but you do have set up a program that will obtain copies of the software and test the software for whatever performance characteristics are indications of quality for the software.

Value is proportional to actual value in commerce. Functional alternatives and workarounds diminish value considerably. The following are several scenarios or information that should be helpful in deciding what approach to take.

Most universities license their names and symbols for use on clothing for 7.5-8.0%. However, this is a case where the university has built all the value in the mark. On the other hand, clothing is a pretty low margin business.

Software obviously has much, much higher margins than clothing. But the licensee of the mark will be responsible for building most of the value. I keep thinking something like 15%

or so might be appropriate as a target. Perhaps starting lower and then ramping up to 15%.

Seriously consider selling the trademark outright and take the payments in the form of installments payout per sale. The dilemma: why pay to build goodwill for a mark, when the prospective licensee can avoid you and create their own mark and save the 15% royalty?

The Pan Am logo and trademark sold for only \$1.3M and it is one of the most famous marks of all time.

Another problem is that if the subject mark is sufficiently descriptive to have recognizable meaning e.g., "lowest fares", it may not be as enforceable as a more distinctive mark e.g., "orbitz."

7. A new startup company is being formed to commercialize software created at a (public) university. As the current deal stands, it will be an 'exclusive, perpetual' license, and there will be no royalties. Instead, there will be 2-3 nominal (i.e., ~\$25K) payments and the new startup will owned by my startup group of five and the university in an equity share. What should the ownership structure look like in this scenario? Should the start up include in the term sheet that the fee payments will be paid only upon the university performing certain technology transfer related tasks?

The structure will vary depending on what each party brings to the table. They can range from 96/4 (company/university) to 50/50 depending on what the university provided with respect to the final product or how much the company will have to spend to develop the technology into a product.

Fee payments can be tied to completion of specified activities but be sure the activity is well defined and the criteria for completion well understood. Negotiation can follow.

8. A set of (copyrighted) CD-ROMs containing surface and gross anatomy video clips was created. They are designed as teaching materials for students in medicine, nursing, physical therapy, etc. The target market is universities with these types of course offerings. Some price targets are being considered but more advice on pricing levels and pricing structure with the following additional factors to consider:

- **Simplicity is key. Goal is to minimize administrative and enforcement burdens for us and for the creators of the videos. Desire is a "ready-to-sign" license agreement with a one-time payment for an unlimited site license.**
- **some monitoring capability exists but password management is not of interest (Although the CD-ROMs are local, they are indexed via a web page that can be password protected).**
- **an updated version will be available in 18-24 months but the basic content is not likely to change soon.**
- **there might be individuals (e.g. private practitioners) wanting to buy the videos as a reference volume.**

How should the private practitioner market be priced without creating a loophole for larger users?

How should the upgrade for new and existing licensees be structured?

Should the same price be charged to a large state university as to a local tech school?

Explore Microsoft's licenses page which gives details of volume licensing, non-profit institution vs. corporate licenses and other factors that might be relevant. See <http://www.microsoft.com/licensing/Default.asp>

9. How do you license or sell a database as either a training or research tool? The situation background: Rose Biomedical partnered with a private company and NIH to conduct a clinical study of algorithms designed to improve predictability and decision support in fetal

monitoring. While the company's algorithms did not provide a statistically significant improvement in predictability, the two years of research did yield an extensive electronic database of 1300 cases (approximately 200 abnormal) that is richly detailed – fetal monitoring strips correlated to patient demographics, course of labor, delivery and outcomes. The database might serve as a valuable resource for a) fetal monitoring research, b) interactive or regular CME training on fetal monitoring interpretation and/or c) manufacturer research in product improvement, clinical use. Examples of questions are:

- 1. If fetal monitor manufacturers are approached how should this type of database be sold or licensed to CME course developers?**
- 2. What price is suggested for license or purchase of all or part of a research database?**
- 3. Are there any regulatory constraints (other than deleting patient identifiers such as names and dates) that should be factored into the equation?**

Sell for use in training, because there is usually a clear case flow stream to support the database and everything else is pulling off overhead. On R&D use it may be easier to get a share of downstream royalties from outcomes and possibly some R&D money for development by the owner, ala a CRADA.

Pricing with databases is much like everything else. If comparables exist, use them. While the database is sometimes buried in the training software, etc., it is usually possible to get an estimate as to what percent of the value of the training is attributable to the database. Be sure the two databases are comparable and adjust percentages to differences in value

Determine the demand or need for CME training on fetal monitor interpretation and is there even a perceived need. If no comparables exist, survey end-users and experts to determine the value add or percent incremental a customer would buy and what would they pay for it.

Clearly patient identifiers need to be eliminated. Consent forms should be in place. Remember consent might be for research purposes only and not for commercial purposes.

10. What are the options a licensor has when a licensee files for bankruptcy with respect to a license?

If a licensee goes Chapter 7, full bankruptcy filing, then the license will be considered an asset of the company and is subject to the ruling of the bankruptcy judge as to what happens to it. It may even be sold or transferred to a sublicensee to satisfy the debts of the company.

Under Chapter 11, it is the same except that the company may continue to operate to pay its debtors and pay the licensor only a fraction, if at all, of licensor's royalty while it seeks to reorganize its debts. Again because it is an asset of the company a licensor may not be able to terminate it fully. The debtors usually get paid first.

The only thing to do is to terminate and file claim as soon as one becomes aware that a bankruptcy petition is filed or seek termination as soon as possible before bankruptcy is filed. By filing a claim one may at least be able to get back the license rights or get a royalty if a licensee continues to operate.

Many licenses are by their own terms non-assignable (i.e., terminate on transfer to a successor to the assets) and terminate automatically on bankruptcy. The bankruptcy code specifically addresses IP in bankruptcy, balancing the start-up's need to retain its IP, with the university's need to assure it gets paid. If the university structured the transaction as a "loan" secured by IP, then you can repossess. If the university simply has a royalty in the future, how will you file a claim for a debt certain - a fixed dollar amount due?

How can one prevent this from happening? First, place specific language regarding remedies for bankruptcy in the agreements. Place contingency language that says that obligations to pay royalties shall be continue if, in fact the license is dispositioned to another entity. Lastly and most important, make sure that you establish good diligence criteria in the license and

monitor your license arrangement. As soon as there is any breach of contract initiate the termination process prior to the bankruptcy filing.