

NEGOTIATION Q AND A (8/8)

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. In setting the "price" should one start with the highest proposal or start low?

Don't price high, hoping to get more than is actually sought - can scare other party due to the unreasonable request. Assume other party knows market. Best is not high - it is where one would like to be - so price within range of the market.

2. Is it prudent to make the 1st offer?

There may not be an advantage in going first or last - best is to know market, and make a reasonable proposal. This approach is more important when you go up against a more powerful party. Do not conclude money is the only issue. There may be other real issues what could they be?

For example, assume when negotiating a lease for a client/tenant the landlord does not want to give any more free rent, but you wanted to try to get more. They seemed adamant. However, you sensed that the real problem was that the agent for the landlord did not want to trouble himself with the number of changes throughout the lease that would have to be made in this case.

Figure out a way to make a minimal number of changes, visit the agent's office and show him how easy it would be to make the changes. The agent may accept the changes and you might save thousands of dollars. Here the issue really wasn't money, it was an administrative problem.

3. It is recommended that one should determine the true interests of each party. In addition it is suggested that one not rely on what the other party says their interests are because frequently there is much more going on than what meets the eyes or ears. How can you develop the skill of uncovering those unspoken interests?

One way is to generate a number of possible solutions before deciding what to do. Allow the parties to "brainstorm" in a pressure free environment. Sometimes you might want to use a facilitator for this purpose. But keep in mind that at the brainstorming meeting no decisions are being made. This session is to get people to communicate and not feel guarded about their thoughts.

4. Consider the following scenario: 1. The institution in question has a licensing staff who draft and negotiate, but do not sign, license agreements; 2. A practice of some licensing staff in this institution is to negotiate terms and conditions as would be normal --- but with the notation, "THIS IS NOT AN OFFER." placed on all agreement drafts and related correspondence. As a licensee, what is your opinion regarding this approach and if you agree with it how would you enact or justify such an approach?

Organizations that do not allow negotiators to have the delegation of authority to negotiate, within proscribed and prescribed limits will come out second best, if they come out at all. The negotiator should be empowered and not just be a "figure head".

Consider a two-step approach, especially for a new licensing effort where there is little precedent. In the first step offer a Memorandum of Understanding (MOU) which is a bare license showing all the clause titles and only offer details to the preamble (the whereas), the grants clause, the compensation clauses, and perhaps one or two more if needed to get things started.

In the second step provide an essentially finished document that only needs dates and notice verification, and the sign-offs. Use of the MOU (which is not the agreement, but a memo to enable further negotiation and closure as expediently as possible. Make sure the preamble correctly identifies the players which might not be the immediate licensee but only a division of a larger entity who would stand behind the ultimate agreement, (it could be a bank). The real negotiation goes on in the MOU step, and step two can be the final act after the plot is known.

As a licensor, do not use the "NOT AN OFFER" qualification. It raises questions about creditability of the negotiator -- like the car salesman and the sales manager on the mezzanine scam.

Some negotiators sign every license draft sent out, indicating a willingness to be bound by the terms of the draft. It is not necessary to go that far, but one can send out drafts with the statement in a cover letter that one is prepared to sign the agreement as drafted.

Encountering situations in which one thinks they have reached agreement, only to have a licensee's negotiator relay that the boss wouldn't approve what had been agreed on. It's hard to take negotiations seriously after that.

5. You have a unique product and have been advised to start at the top of the industry with an offer of exclusivity, which you have done. You believe you have good legal advice but need good licensing information. What are the pros and cons of an attorney doing negotiations or yourself? How do you know fair value? What shouldn't you do?

Now is when you need some business info otherwise your negotiations are just guesses. Research on the market sizes and margins of similar type products will be useful in negotiating performance guarantee levels and royalty rates. Shoot for a performance guarantee that's about 25% of a conservative projection for sales—enough that it's "costly" if they just sit and pay the guarantee but not so high it isn't realistic to pay it if things go slower than they (and you) would like. If you are aiming for an exclusive license you can possibly get away with asking for more here but expect them to reduce any up-front amount and maybe even the royalty rate. Keep in mind that it's in their best interests to be wildly successful so all you are doing is guaranteeing that they have an active interest in getting there sooner rather than much later.

The higher the margins the higher the royalty percent of the wholesaling sales price should be. The net result should be you get about 20% of the "profits" after the overhead is factored in. In many cases this works out to a royalty of between 3 and 7% but this can vary tremendously. A quality window fashion treatment might even merit a 10-15% royalty under the right circumstances--especially if it's a high-end product. You'll need to evaluate your invention versus alternatives, etc. to figure this out. They are unlikely to tell you what margins they expect or what their overhead rate is so you'll need to do some research to get general industry info. The Robert Morris & Associates web site (www.rmahq.org) and/or their Annual Statement Studies Book (at large libraries with business collections), only \$129 for non-members, are good places to start. They list over 500 SIC codes you can get average numbers for.

It won't hurt to have an attorney ASSIST with negotiations if that will make you more comfortable. If you can I highly recommend you be actively involved and focus the negotiations on the business deal (royalties, guarantees, up-front payment) and leave the "legal" technicalities to dotting i's and crossing t's till near the end. Where it gets interesting is in the in between areas such as who is responsible for pursuing patent infringers (my bias is to let them be responsible but with your cooperation and non-financial participation, then they get 95 or even 100% of any award/judgment). Some licensors even leave the issue out entirely on the grounds it can be decided if it ever comes up.

Know the whole industry size and major competitors. Know the product line and how well it fits with your product or product line. If your product would overrun a competitor's cash cow you should be prepared to explain its benefits. If it fills an obvious gap in a line and provides an edge over specific competitors your case will be further enhanced.

You should not expect to just make wild demands without being able to provide (or cite) evidence they will believe. You probably should not expect to close the deal in one session but if you are prepared and knowledgeable you shouldn't rule it out either. Regardless you'll likely want a "formal" signing of the final agreement documentation at a later date.

6. As an attorney involved in technology transfer, what constitutes the practice of law in representing private inventors in licensing their technology? Can a non-attorney/ non-law firm represent a private inventor in negotiating and structuring licensing agreements? At what point does this representation constitute or generate an attorney/client relationship?

Suggestions for a non-lawyer technology transfer agent:

- a. specifically disclaim the practice of law,
- b. do not discouraging the use of a lawyer by a business client,
- c. avoid preparing contracts, especially ones involving great risk to clients and involving third parties, and/or
- d. do not render opinions on matters involving the impact of the following on a business client's situation: case law, statutory law, civil procedures, contract law, court operations, etc.

Listen to lawyers and consider what they say but, unless they can cite law on a point, do what you believe is right and advise clients to think for themselves. Many lawyers have less experience in intellectual property management and transfer than a professional technology transfer person so do not succumb to slavish adherence to opinions of lawyers. Recommend that lawyers be involved in final preparation of contracts, licenses, etc., particularly to assure the law of jurisdictions is correctly stated and observed. Not all technology transfer practice is the exclusive province of lawyers (or other trade unionists).

There is little difference between selling technology and selling real estate. Few would suggest that realtors "practice law" even though they fill out standard form contracts.

The job is negotiating terms, not resolving legal issues inherent in any contract. However, technology transfer people who are not representing employers can get into unauthorized practice trouble when legal issues arise, and they purport to resolve them without advice of counsel.

A patent agent with an active practice of writing patents for inventors helps sell inventions and provides advice on sales and marketing approaches. When an agreement is nearing conclusion the best licensing and litigation attorney should get involved to address legal questions. If activities fall outside a patent agent is licensed for, i.e. prosecuting patent applications with the USPTO, an attorney needs to get involved. A lawyer review of the final agreement is recommended.

Licensing is a different world than patent preparation and filing. Know what you want before you start negotiations. There is no conflict in employees negotiating and signing agreements for their employers but a real conflict exists when non-lawyers take on legal chores for individual inventors.

- a. A license is a business document based in, and on the law. It is first and foremost a business document, and as such should be negotiated by business people in furtherance of their mutual business agenda.
- b. Second, a license, as any new business venture, represents a risk. However, attorneys are paid to reduce risk as much as possible. Therefore one might conclude that a conflict exists between the business, risk-taking attitude required to market and license an invention, and the attitude of a risk averse attorney trying to do her/his best to protect the client.

Use marketing and business skills to create the business model for the license. You will need to learn a lot about the market and how things are done within it. Determine who has the most to gain, and who has the most to lose. Assess how the invention (or products based on the

invention) will be sold, by whom, and in that chain identify the best link into which a license should be introduced. Sometimes this is a no brainer, and sometimes, as in the case where the invention creates a new market, or when the invention can be sold as either a component or finished system, things get a bit more complicated. Use business skills to open doors into companies who will potentially license the invention, and then make the business case for its adoption.

The forgoing seldom requires extensive legal knowledge but study the laws governing intellectual property and anti-trust (among other things), to make sure a business model is practical and based on law (principles of international exhaustion is one example). When negotiating a license, discuss business needs and concerns with a fellow businessperson. Run the final draft of the license by an attorney and discuss key issues with he/she before and during the negotiation. They are there to make sure you don't get into trouble, and to inform you of risks. It is up to the businessperson to decide which risks to take.

Further evidence of the business lead with legal support is emphasized by the number of university technology transfer offices that substantially increased revenues once management of the technology transfer office changed from attorneys to business people. However, there are some already successful technology transfer offices being managed by very talented (business savvy) attorneys.

7. Equity deals in the licensing of technologies by universities to spin-offs have become more popular in many places. In Switzerland, we are just starting to do such deals. I am very interested to learn from you on how the following issues are handled and what experiences you have made with your policies:

A. Inventors usually get stock directly from the spin-off company as co-founders. If the university accepts stock as part of a licensing deal;

- a. **do the shares fall under the normal revenue distribution scheme (inventors, institute, university, etc.) used for licensing revenues?**
- b. **does the university not give any shares to the inventor because he/she is compensated directly as a co-founder? If this is the case, what distribution scheme is applied instead?**

B. What happens with the shares, i.e.;

- a. **does the university keep them or are they held in trust by a third party due to concerns about conflict of interest issues, etc.?**
- b. **are the shares distributed (inventors, institute, university, etc.) or do you distribute the money after the shares have been sold?**
- c. **who decides about the exit strategy?**

Try to follow these principles:

- a. What the inventors did before the company formation was on behalf of the university. They share in the normal way (according to university policy at the time) in returns that arise from equity received by the university (in our case via the university research foundation). These shares usually are in the form of restricted stock which is not marketable. They then are held in trust by the foundation until they become unrestricted, or are swapped in a merger for unrestricted shares. At that point they are distributed. Otherwise, the foundation might incur fiduciary obligations for managing the inventors' investments. If the company is acquired and the stock is purchased, the cash received is distributed at that time.
- b. What the inventors receive from the company in roles as consultants, founders, directors or officers really is for future contributions to the company, not what they have done in the past (which again is university-owned). Normally, they receive this equity compensation in the form of stock options, not stock grants. The options typically vest over time. Generally, we encourage inventors who will take an active role in companies

- to take fractional appointments or leaves of absence from the university. This greatly simplifies management of possible conflicts of interests.
- c. Exit strategy is determined by the business plan in terms of what is acceptable to investors. In this case, the university (again via an autonomous research foundation in our case) is a de facto investor -- accepting shares instead of cash for at least partial payment under a license agreement. Investors need to agree with the exit strategy or they will not invest. In this case, no license will be granted, unless the deal makes sense to the university. Obviously, the situation is much more complicated if shares are directly held by a university, and particularly by a public university. Having an outside, not for profit, foundation to hold shares and do the deals greatly simplifies matters and provides a measure of detachment of the university from liability issues that might arise in association with ownership or other involvement with a startup company. (Consult your legal advisor on such matters of course.)

Beware of complicating factors related to tax laws, Bayh-Dole law re: University inventions, export control laws regarding sensitive technology, as a few examples. What if an interested third party is not a national?

8. How should terms of the contract be negotiated?

Make sure someone on your team knows a thing or two about negotiations and has done their research on past cases with similar technologies/licenses.

Successful negotiation is both a science and art. The more that is known about the prospective party's needs, desires, business objectives, etc., etc. the better position one is in to negotiate. Also, you must have a very clear picture of your own expectations, bottom line requirements, etc., etc. We highly recommend that said negotiations be left on the hands of experts otherwise you risk killing any potential deal and/or leaving millions of dollars on the table.