



autm

Transforming Ideas into Opportunities

Sub-licensing: Horror Scenarios &
How to Avoid Them

Speaker



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- > 20 years commercial experience
- Large corporate, VC, tech transfer, consulting
- High value transactions
- IP-centric divestment and acquisition, Start-ups, JDAs, JV's, Public-Private Partnerships



When does sub-licensing become important?



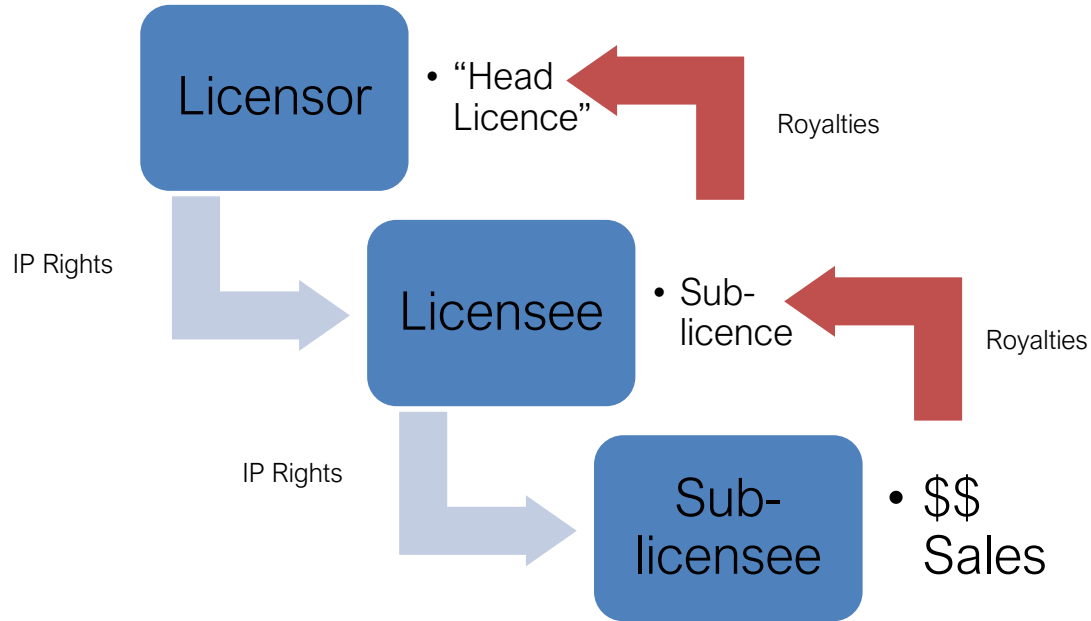
- Time and focus spent on terms and conditions for the licensee
- But what if the licensee isn't going to take the IP to the market and will look to sub-licence?
- The value of the asset will have changed from the time the main/head licence was signed
- Are everyone's interests aligned?

Sub-licence...or not?



Can simply “turn off” sublicensing
But watch out for grant clause
language: “*have made*”, “*have sold*” –
imply ability to sub-licence
Particular issues raised with “have
made”
Sub-licensing only with exclusive
licences?

Who collects sub-licence income?



Collecting royalties

Head licence may contain financial terms e.g. net sales royalties, signature fee, milestone payments, annual fees, etc.

How do these translate to the sub-licence?




Collecting royalties



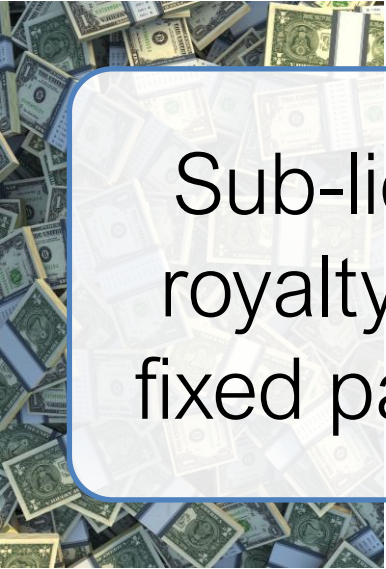
Good idea to specify that transaction is “arm’s length”

“An arm's length transaction refers to a business deal in which buyers and sellers act independently without one party influencing the other. Arm's length transactions assert that both parties act in their own self-interest and are not subject to pressure from the other party”
(Investopedia.com)

Two main approaches

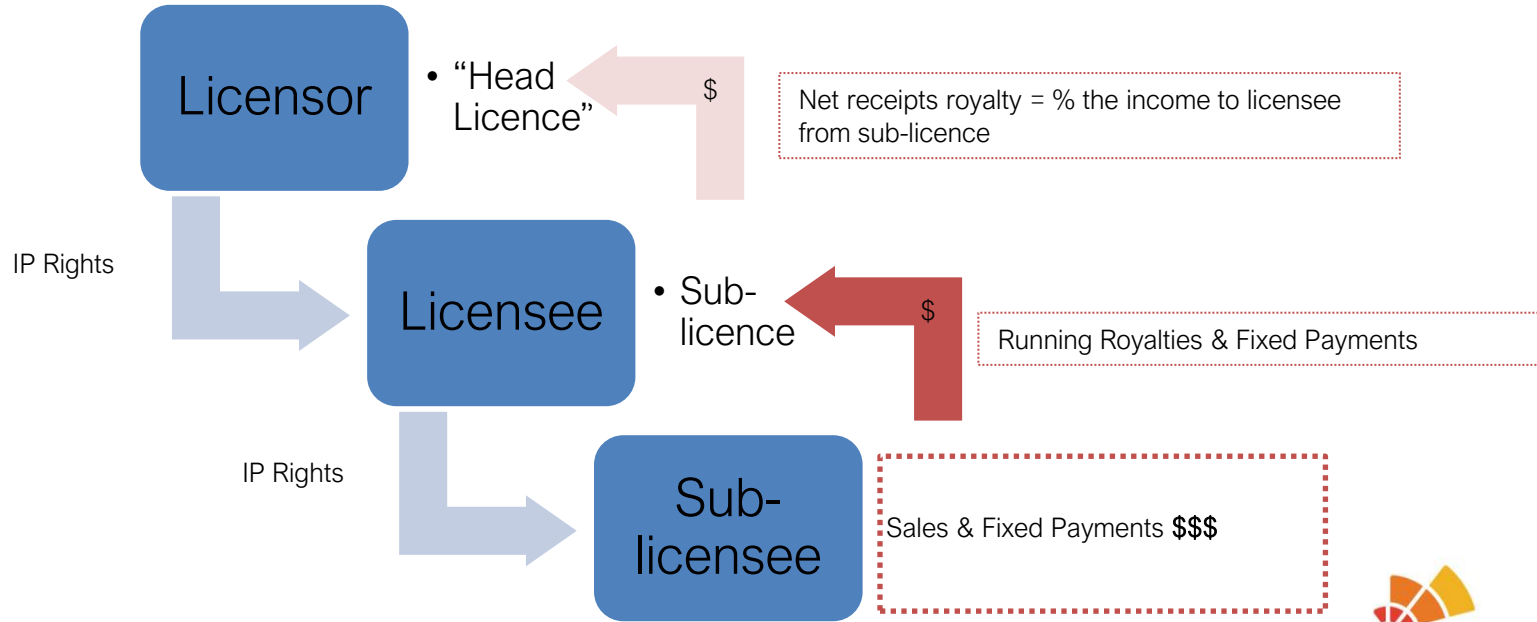


Net receipts
royalty



Sub-licensee
royalty + % of
fixed payments

Net receipts royalty approach



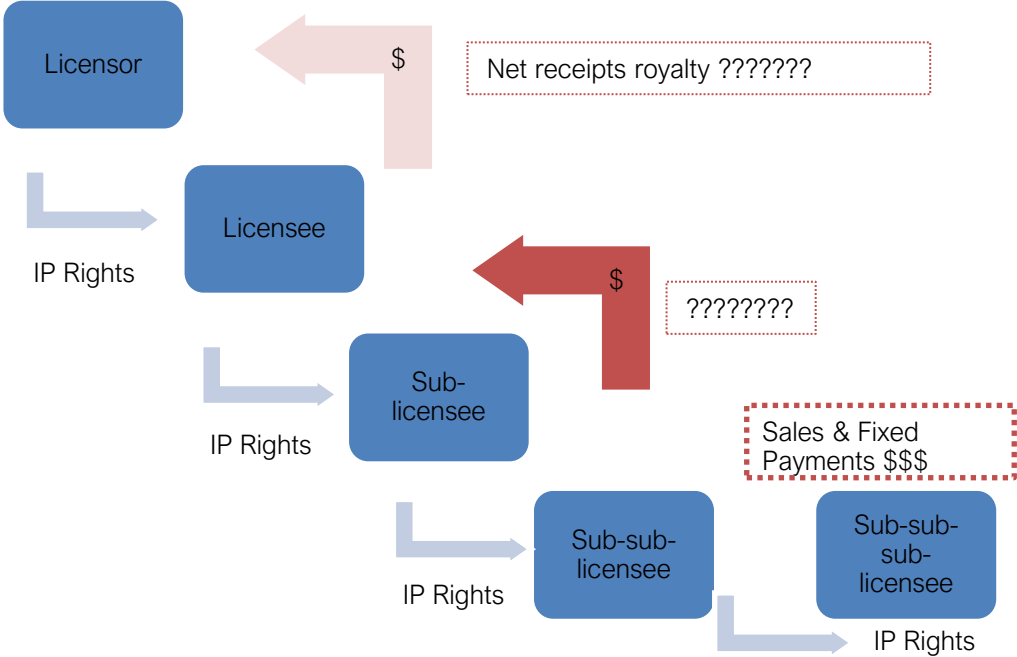
Net receipts royalty

Take percentage royalty of all sub-licence income (net receipts) regardless of source

- E.g. net receipts royalty = **10%**; licensee negotiates sub-licence with **\$1m** milestone and **7%** royalties. Sub-licensee reaches milestone and makes sales of \$40m. Income to licensee is **\$1m + \$2.8M**; return to licensor is **\$100,000 + \$280,000 = \$380,000**
- Is this approach affected by certain types of deal?

Net receipts further considerations (1)

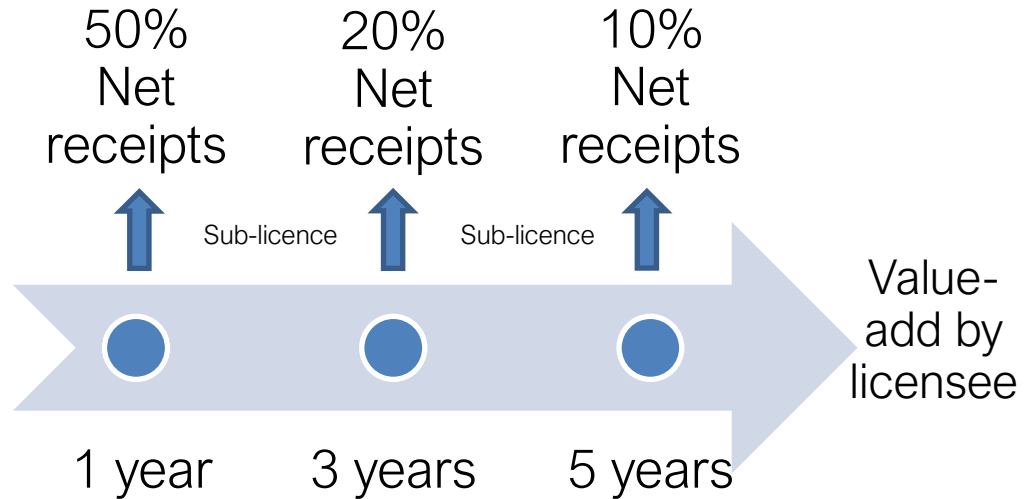
Tiers of sub-licensing



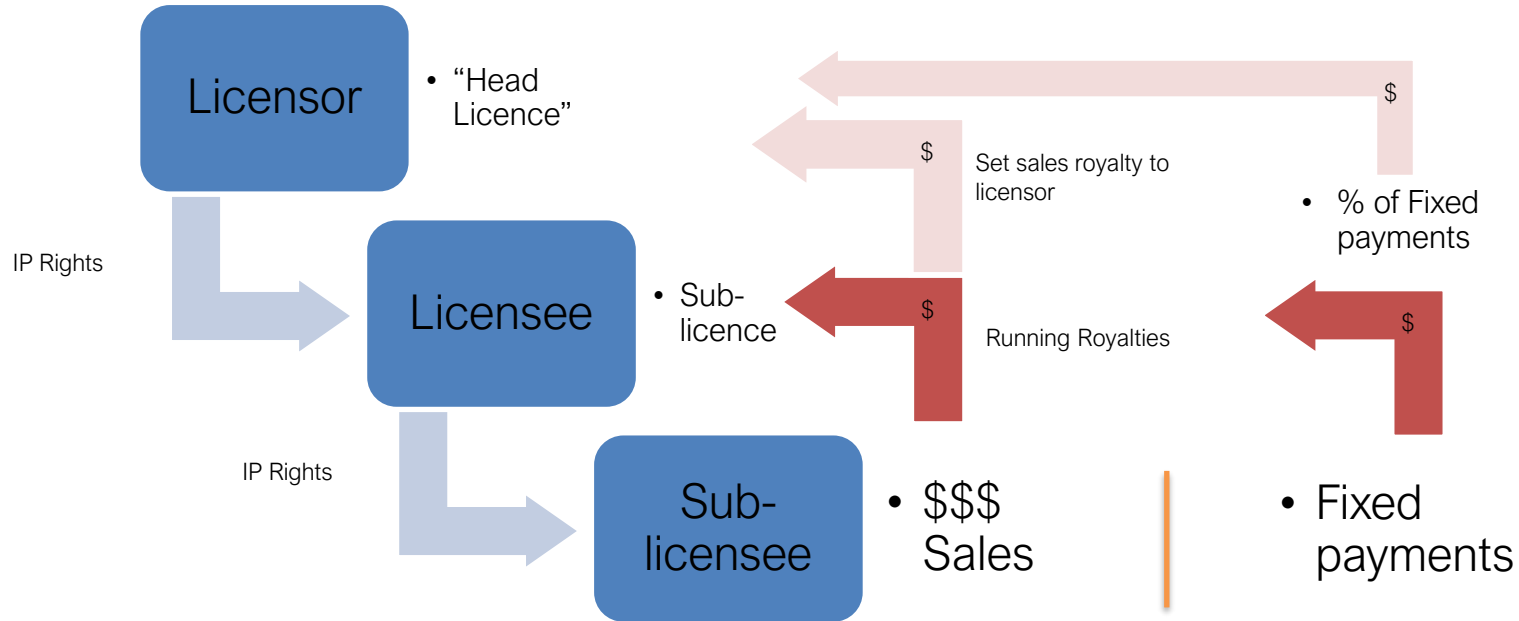
Net receipts further considerations (2)

Timing of the sub-licence

- Net receipts % assumes significant value-add by licensee
- Consider tier-down to prevent technology “flipping”
- E.g. 50% if sub-licensed within 12 months, 20% if sub-licensed between 1-2 years, 10% thereafter



Sub-licensee royalty approach



Sub-licensee royalty approach

Royalties on sales and fixed payments handled differently:

- E.g. fixed payments royalty = 10%, sub-licensee royalty is 4%; licensee negotiates sub-licence with \$1m milestone and 7% royalties. Sub-licensee hits milestone and makes sales of \$40m. Income to licensee is \$1m + \$2.8M; return to licensor is \$100,000 + \$1.6M = \$1.8M
- Key question – can the licensee obtain a high enough net sales royalty in its sub-licence? E.g. in this example, more than half of net sales royalties received by licensee go back to licensor!

Sub licensee royalty

A Net Sales royalty applies to whoever makes the sales

Setting this royalty

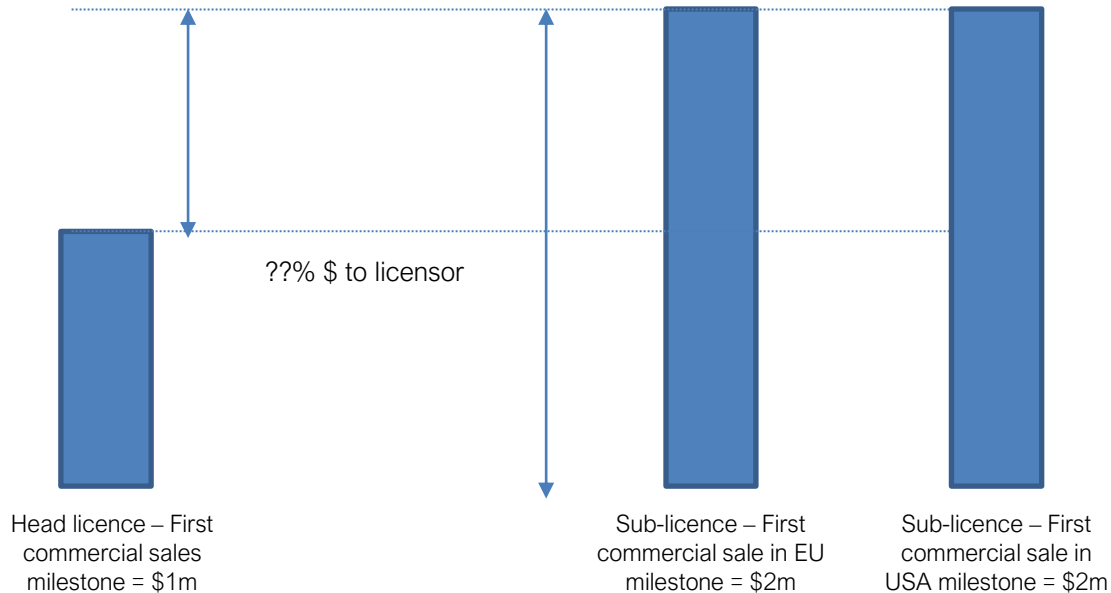
- The same as the licensee net sales royalty?

Also set percentage of fixed payments

- How to match against milestones in head licence?



Sub-licensee royalty fixed payments



Sub-licensee royalty and net receipts comparison

Net receipts	Sub-licensee royalty
Simple to calculate	Involves separate calculations for different sub-licence income streams
Gives licensee flexibility on sub-licence deal terms	Can make sub-licence uneconomic
Vulnerable to certain deal types	Surety on royalties from sales
Vulnerable to multiple sub-licence tiers	Unaffected by sub-licence tiers

Levels of control – not just financial



RESTRICT WHO CAN BE
A SUB-LICENSEE



CONTROL THE NUMBER
OF TIERS OF SUB-
LICENSING



FLOW T&C THROUGH



REQUIRE THAT LICENSEE
SHOWS COPIES OF SUB-
LICENCE

Termination

What happens if a sub-licensee breaches the agreement?

If the head licence is terminated – what happens to the sub-licences?

Opt-in/opt-out/tail out – consideration for software/EULA

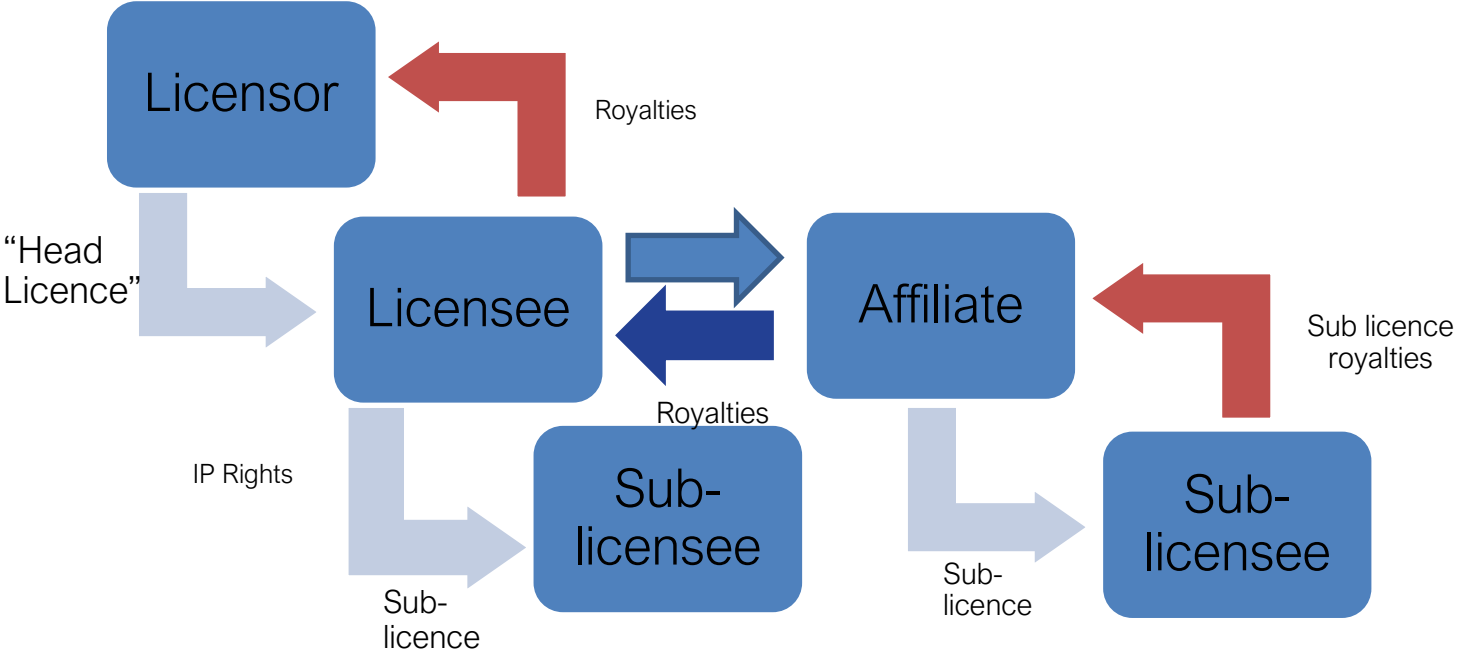
Special case of sub-licensing (Affiliates)



Care required in treatment of Affiliates in sublicences

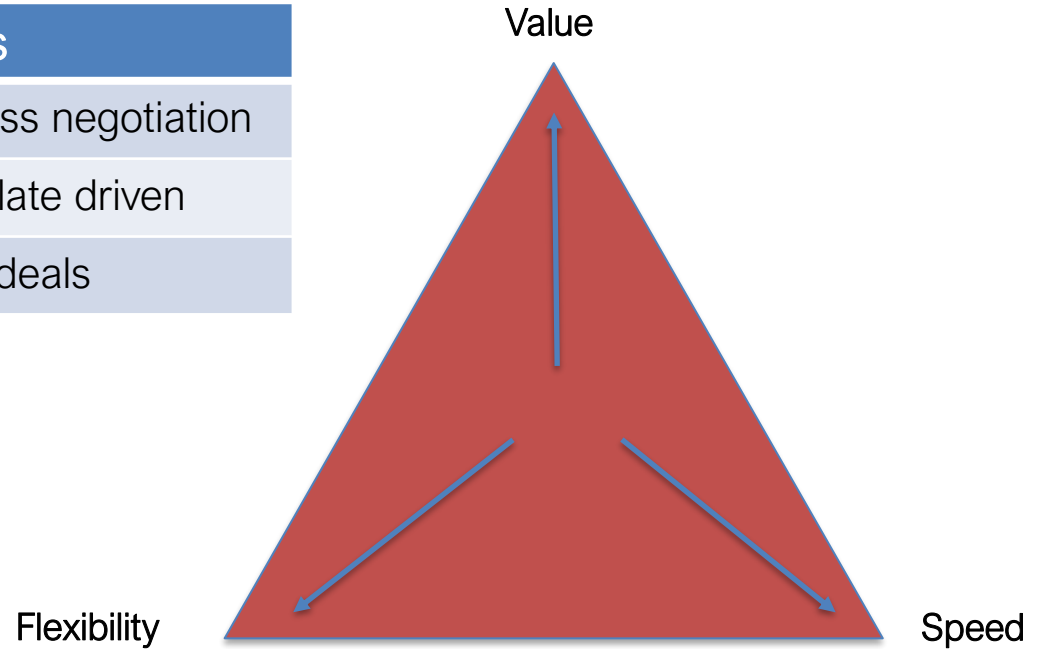
- Preferable not to licence directly to Affiliates
- Allow (unlimited) sub-licensing to Affiliates – as long as they remain Affiliates.
- Affiliates are treated as licensees for the purposes of royalty collection
- If an Affiliate issues a sub-licence then the appropriate sub-licence royalties apply

Dealing with Affiliates



Sub-licensing Strategy?

Value	Flexibility	Speed	Risks
✓	✓	✗	Endless negotiation
✓	✗	✓	Template driven
✗	✓	✓	Poor deals



The Sub-licensee perspective

- Needs full rights under the sub-licence to enjoy the benefits of the technology!
(or no royalties for anyone)
- If receiving rights through many tiers and packages of IP, can be very challenging to understand all the obligations being imposed
- Is typically required to indemnify everyone without having developed the IP or do full diligence on the original technology and IP package
- May want to ensure rights are not contingent on licensor receiving payments!
- Stand-by licence – the event head-licence is terminated (opt-in, opt-out, or tail out)

Key points on sub-licensing



LICENCE INCOME CAN BE
SIGNIFICANTLY AFFECTED BY
SUB-LICENCE TERMS



CAN BE COMPLEX TO WORK
OUT HOW TO COLLECT
INCOME FROM SUB-LICENSEES



CONSIDER AN APPROPRIATE
LEVEL OF CONTROL

Thanks for listening/Q&A

Please get in touch

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