Overcoming Objections to License Terms

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Introduction

This chapter is designed to give you tools to use during the negotiation of a license agreement between a not-for-profit university or institute and a for-profit industry partner. It addresses some of the more common objections raised during the negotiations so that you may be aware of what to expect. Further, it provides the not-for-profit some suggestions for handling these objections and preventing them from causing the negotiations to fail.

It is not intended that this section be all-inclusive. Even after twenty years in the business, a technology transfer professional can find new and original issues cropping up in license agreement negotiations. Thus, this chapter cannot cover all issues. However, it will address some of the more common objections.

Commercial corporations are accustomed to everything being negotiable. They have guidelines and rules that are stable for the most part, but what the contract contains hinges on is profitability. If the negotiated deal makes sense from a financial perspective, rules and guidelines can often be bent.

Universities and other research-intensive entities, however, often play by different rules. There are firm rules that supersede profitability. Sometimes it is better to walk away from a deal than to waive or bend a rule. This stems from the fact that nonprofits often represent constituents consisting of the public, elected officials, and government, rather than stockholders.

Regardless, every negotiation, whether for-profit or nonprofit, is based on one key aspect for bringing it to a timely close. That one aspect is whether or not you can meet the ex-

pectations of the person with whom you are negotiating. To meet the expectations, you must first understand the expectations.

Years of experience demonstrate that this is an advantage for the nonprofit. Why? Because the ultimate measures of success are often different for the corporation and the nonprofit. Where the corporation is focused on the bottom line (profit), the nonprofit is focused on getting the technology out for public benefit.

You may have more detailed expectations to meet. The corporation may need to use money available in this year's budget. Alternatively, it may wish to postpone costs until next year's budget. You may be able to time your due dates to accommodate its needs.

It may need to conserve cash. It may have cash on hand but need to keep the product cost low. You may be able to adjust a balance between royalties and fees to reach an agreement. But, in any event, you must understand the corporation's expectations.

Since the measures of success for nonprofit and for-profit are different, there is almost always a way in which both parties can benefit and call the agreement a success. This fact makes negotiations between institutions and corporations a joy to undertake. Your success rate in concluding deals is likely to be very high.

There are, of course, still challenges in getting to yes and concluding a contract with a corporate entity. That is why I have written this chapter, to help you with the hard spots along the path of negotiation.

Following, roughly in order of the number of occurrences I have personally experienced, are topics that I have found to raise objections during negotiation. With each topic is a discussion of some tools you may wish to use to counter objections.

Sublicenses

You must determine if it makes good business sense to allow your licensee to grant to others the same rights that it enjoys in the license agreement. This right to sublicense allows the

licensee to act as a middleman or an agent, representing your intellectual property rights to others. This is often allowed in exclusive license agreements where you would like your licensee to act in full control of the intellectual property. It is seldom seen in nonexclusive license agreements, since the intellectual property rights owner usually wants nonexclusive licenses to come only from them for tighter control. Of course, as in most of intellectual property matters, there are plenty of examples of exceptional cases where these general rules of thumb do not apply.

If you have a nonexclusive licensee who wants the right to sublicense, remind the licensee that it would be confusing to the marketplace to have both you and it offering licenses and could lead to difficult situations if the terms were different. Let the licensee know it is your institution's decision to remain in control of licensing the intellectual property rights.

If that is not convincing, you will be faced with weighing the risk to your institution of having a nonexclusive licensee representing the rights to the intellectual property at the same time you are doing the same. If, for instance, you are addressing different markets, then it could make sense to proceed under such circumstances.

Control

Here is another factor to consider in sublicensing. Many templates for exclusive license agreements grant rights to the licensee that allow it to sublicense rights in the same scope of the grant it has been given. These templates sometimes have a clause that requires the licensee to get consent from the grantor before entering into a sublicense. You may want to have this strict control, since the licensee will be acting as a middleman or agent for you in representing the intellectual property to others. You may find, however, that processing such requests for consent may be time-consuming and unproductive. In such cases, you may wish to consider replacing the consent clause with one that simply states limitations you can live with in sublicensing practice.

For instance, you could simply require that the licensee refrain from entering into sublicense agreements that are objectionable to state and federal law and the policies of your institution. That may be the criteria you would use to review a sublicense on a consent

basis anyway, but now you have not delayed the process. A more general approach like this can save time in cases where you don't really want to have to examine each proposed sublicense agreement.

Regardless of which clause you use, it is a good idea to contractually require that the licensee provide you with copies of all sublicense agreements. That will allow you to monitor the progress and ensure you are not being misrepresented. You might also insist that the licensee include in its sublicense agreement a clause indemnifying the institution, echoing that of the primary license agreement. A direct indemnity is your best protection.

If that is a barrier to sublicensing the intellectual property rights, an alternative would be to incorporate in your agreement language stating that the licensee will indemnify you against actions stemming from sublicense agreements. Before drafting language that would include a clause asking the licensee to ensure that the sublicensee indemnify the institution, check with your state laws to ensure they allow third-party indemnity. More on the issue of indemnity follows in a later section.

Determination of Sharing

When a sublicense agreement is in place, it will hopefully begin to generate revenue. How that revenue is to be shared between you and your licensee is spelled out in the license agreement. But, what should the split be? How should it be expressed?

The division of revenue depends on the business model being employed. Most of the time, the model used is in the form of a royalty on sales paid from the sublicensee to the licensee. Ideally, you would like to receive the same royalty whether the licensee sells directly or uses a sublicensee to make the sale. In this manner, you are whole (in a business sense) regardless of what business model the licensee uses. This is good for the licensee also, in that it is free to structure its business in a way that is best-suited for the market and change it along the way if the first method doesn't work. Thus, a good starting point is to ask for the same royalty that you would get if he or she made the sales directly.

But, what if the company structures a deal with its sublicensees for annual fees and doesn't plan on tracking individual sales? Or, what if the deal combines fees and royalties

in a proportion not anticipated and a fixed royalty coming back to you would not work for the company?

In such cases, it may make sense for the owner of the intellectual property and the company to split the total revenue stream equally. This is often a starting point in such negotiations, where the revenue stream is complex.

Template license agreement language reflecting this kind of split is often misunderstood. It sometimes reads, "Licensee will pay to university fifty percent (50%) of revenues from sublicensees…." From my experience, this is often interpreted as a 50 percent royalty on sales of product or services made by the sublicensee, when it is intended to be more closely related to a royalty collected. I say more closely, because sometimes the deal between licensee and sublicensee is not strictly a percentage of sales, but may be an annual fee or a fee tiered on sales volume or some other arrangement.

So, in a case where a 5 percent royalty is fair value, the corporation may be thinking you want a 50 percent royalty if a sublicensee sells the product while you are thinking that you will get half of something close to 5 percent. Have an example on hand of how the transactions would take place if a sale is made. A good example will go a long way to resolving this issue of potential misunderstanding.

I have also found it helpful to rewrite template language to use the word *half* instead of fifty percent (50%). For some reason, that doesn't trigger the association with a royalty on sales quite as often. You could, of course, also leave it blank so an explanation can accompany the negotiated figure. This approach has the downside of failing to set the expectation that you should receive half, of course.

There are other arrangements that may make good business sense as well. If the licensee adds the licensed technology to a larger portfolio and licenses rights to the entire portfolio to a sublicensee, you may wish to settle for a smaller percentage of the sublicensee payments, since they might consist of one payment for the entire portfolio of rights.

It might arise in a completely different business model that sublicense revenues are the only income to the licensee, in which case some percentage may go to support its overhead costs prior to the split.

You can think of many ways to structure the sharing of income from sublicensees. You might begin with template language requiring the same royalty regardless of who sells the product or service. If there is objection, then consider a half-and-half split, but be liberal in coming up with alternative sharing mechanisms that make the business model work.

Most of all, make sure you have structured a deal that allows your licensee enough flexibility to modify or adjust its business model in a way that provides the best chance for commercial success. If your licensee cannot succeed, then you will not benefit. Worse, you could find yourself back at square one, looking afresh for a new licensee. So, understand your licensee's requirements and create a winning scenario for the licensee and yourself.

Software

If you are licensing software, you will have several interesting business models to consider. The simplest is one in which you license software directly to the end users. In this business model, it is likely that end users will expect that they can call you for support when their screen goes blank or they can't get a new feature to work. However, you may not wish to support the sales, marketing, and support efforts to do this, so you may wish to find a licensee who will supply such services and, in turn, license to end users.

Then there is the issue of creating new versions of the software. You may wish to control all new versions of the software or you may want to find a licensee to take over the development of derivative works. In some cases, you may wish to create derivative works in parallel with a company, creating a branch in the development tree ultimately resulting in two products.

Let's take a closer look at a few common business models and the issues associated with the license agreement for each.

Case I: Licensing Directly to End Users

The simplest software license is one to the end user. In this business model you will market the software, create new versions, and (optionally) offer support services to the end user. In this model you would typically prefer to restrict the end user from making modifications, making copies (except for backup purposes), and distributing the software.

The basic considerations might look like this:

Copies	One for backup only
Distribution	No
Modification	No
Reverse engineer	No

In this model you may wish to get creative in how the software may be provided to a number of users from a central server. You will need to consider how to restrict its use for a set fee or perhaps structure a fee per user. Often, these agreements have a fee for the initial software installation, then a fee per user. It is also typical to find annual maintenance fees which may, in part or in whole, go back to the lab supporting the software to help cover its costs.

Case II: Licensing to a Distributor

If you want to control the software development, but don't want to provide support services, consider licensing the software to a distributor, that is, a company that will market and license the software to end users. In this scenario, you will want to restrict the ability of the distributor in modifying the software and creating derivative works. If you can provide only executable code, rather than source code, it would be preferable.

The basic considerations might look like this:

Copies	Yes
Distribution	Yes
Modification	No
Reverse engineer	No

Please give strong consideration to a formal program of software releases in this business model. It is imperative that you maintain control over what version you provided to the

distributor and at what time. This will go a long way to resolving potential problems in the future, when a feature may need to be tweaked for an important customer who has an early version of the product.

Consider limiting the distribution by geographic area or field of use. If you run into objections from a prospective licensee during negotiations, it may be because your restrictions interfere with its business plans. By placing strict restrictions in your original draft and then backing off of them, you will learn a great deal about the details of the prospective licensee's plans.

Case III: Licensing to a Software Developer

In this business model, you prefer to turn the software over to someone who can create a commercial version, market it, and distribute it. You are turning over control of the future of the software for commercial purposes. You will be supplying the source code in this case.

The basic considerations might look like this:

Copies	Yes
Distribution	Yes
Modification	Yes
Reverse engineer	Not applicable

Here's a contentious question. If you licensee creates a derivative work, who owns it? If the licensee owns it, then you may launch down a slippery path where eventually the licensee will claim that the fifth or sixth version looks nothing like the original and therefore does not infringe the copyright. Sometimes that can even happen before the product hits the market.

Although you will very likely get kick-back on this provision, you may wish to join the many nonprofit institutions that require derivative works made by the licensee to fall under the ownership of the institution; put more simply, the institution will own derivative works made by the licensee. At first, this policy doesn't seem right. Why would the institution own a derivative work created by the company?

The problem occurs when the institution does not own the work. When that happens, it opens a door for the company to consider that it is developing works that are moving away from the original copyright. Sooner or later (and more likely sooner) it will consider that the work it is preparing to sell doesn't look like the original work (as mentioned above) and, therefore, no royalties are due.

The defense for such a request is in the purpose, which is to circumvent any contention that a future work does not infringe the original copyright and, therefore, no royalties are due. In fact, you have to wonder why the licensee that insists on owning the derivatives really wants to do that.

This suggestion is not a legal opinion, rather a business one. It can be used to avoid confusion in later years, since it might be thought possible to show that the licensee-created derivative work isn't similar to the original work and, thus, what is being sold doesn't fall within the scope of the license agreement. In all likelihood, however, a good intellectual property attorney may be able to demonstrate the progression from the original work to the one the licensee claims is not infringing and maintain the contractual obligation. But, from a business perspective, who wants to go through such a contentious procedure with a licensee? It is much better to insist on ownership and avoid the later conflict.

Now, if the company still resists, try offering a position where royalties are reduced as the company creates more and more derivations. Presumably, the value of the product is being increased as the company incorporates new features. Thus, you will be getting a smaller percentage of larger sales. I prefer to reduce royalties as a factor of time rather than trying to keep track of the number of version releases. It is an approximation, but much easier to calculate, not to mention avoiding potential arguments on down the line.

Indemnity

Nonprofits often have different standards of indemnifying contractual partners than industry. In industry practice, it is often acceptable to contractually promise to indemnify the other party in preparation for some hypothetical situation when lawsuits may begin to fly. Nonprofit entities, however, seldom do that to the same extent that an industry entity

would. In fact, some state institutions are prohibited. More on this later.
Consider that an industry partner typically licenses patent rights from the nonprofit, then uses those patent rights to design and develop a product and market the product to the public. The nonprofit maintains little control over the process and has little influence over the ultimate product reaching the public. If the product infringes someone else's patent (or even another patent owned by the institution) or ends up harming someone, the responsibility of the nonprofit is likely to be insignificant.

Further, nonprofits rarely have the staff and time necessary to perform a freedom-to-practice analysis that is often used by industry to determine the risk in finding that the contemplated product may infringe someone else's patent (or, again, even another patent owned by the institution). These studies tend to be expensive and require near final engineering designs of the product. Since the nonprofit usually works with early-stage technologies, a freedom-to-practice analysis would likely be money wasted, as it would not reveal much about the licensee's ultimate exposure.

Thus, the nonprofit usually draws a hard line on the issue of indemnity, taking the stance that it will not indemnify the licensee. Further, it generally adheres to the philosophy that the for-profit licensee must assume all risk associated with its efforts to commercially develop and exploit licensed technology. Thus, the nonprofit will ask the licensee to indemnify the nonprofit.

Academic institutions typically employ rather broad indemnity clauses, whereby they stipulate that a for-profit licensee must indemnify the academic institution for any and all third-party actions, claims, or lawsuits arising out of the design, process, manufacture, or use of the licensed technology. Private institutions have a little more flexibility on this issue, but typically follow the same model, since it makes good business sense.

It makes good business sense when viewed from the standpoint that the institution enables the commercialization, but is not in control of it. It would be unreasonable to expect that a party assume risk for something in which it has no control. The institution retains only a minimal interest.

As mentioned previously, some state institutions are prohibited from accepting the liability associated with indemnifying another party. There are usually state laws that govern the extent to which a state agency or institution may indemnify another party in a contractual agreement. You should become familiar with them. Typically, a government entity is restricted from assuming indemnity since it is considered acquiring a potential debt, which may only be done by an act of the legislation.

That said, it is likely that you will encounter resistance on the indemnity clause on occasion. I would estimate that the issue came up for discussion in approximately 25 percent of my cases over fifteen years. Most of the time, a recitation of the above reasoning solves the issue. In the remainder, you are best advised to get your legal counsel to engage the prospective licensee and work on the exact language of the clause. There is a great amount of case law behind the words chosen for the indemnity clause, and you do not want to attempt to change the clause without a legal background in the area.

Royalties

Here is a familiar topic: royalties. A royalty is a payment made by a licensee for ongoing use of intellectual property, usually in return for rights to make, use, and sell (along with perhaps other rights) product or services. The royalty I will discuss in this section is that compensation that is most commonly expressed as a percentage of sales for some defined area (geographic or field of use).

The Basis

The basis of a royalty is most often the whole of some measurable quantity from which a percentage is taken as compensation. It may be the total gross sales of a product that incorporates devices or methods described in the patent that is licensed, for instance. So, as the licensee makes sales, it may report the sales once each quarter and pay a certain percentage to the patent owner. That seems simple enough. But, there many cases where it is not so simple.

Consider, for instance, a case where the product described by a patent is a small part used in a much bigger product. The patent may describe, for instance, a rubber seal that is as-

sembled into an aircraft engine that is sold as a unit. A license agreement would typically ask for percentage of the sales price of the seal, but perhaps it is never sold independently and, thus, no sales price exists.

Compensation could be made a much smaller percentage of the sales price of the entire engine. For instance, instead of asking 5 percent of the sales of the seal, you could adjust a percentage by the ratio of the manufactured cost of the seal to the manufactured cost of the engine. This approach is often suggested by the licensee, and it is often unfavorable to the licensor. The value of the seal may be in reduced maintenance scheduling, which may save the buyer many thousands of dollars a year. However, the manufactured cost may be only $1.50.

A better approach may be to do some analysis on the true value that the seal brings to the sale and reduce that to a fixed fee charged for each unit sold. Most of the time, a fixed-fee structure will be a more accurate representation of the value of the intellectual property than the manufactured-cost ratio. This approach offers the potential customer's savings as the basis, rather than manufactured cost.

Consider the importance of your intellectual property to the sale of the product or service. If your patent describes a primary active ingredient used in a pharmaceutical, then it is critical to the sale. In such cases, a royalty on gross sales makes sense. If your patent describes a coating for the pharmaceutical in tablet form, then it may not be quite so critical. If there are alternative coatings for the tablet form and the drug can be made in liquid and capsules that don't use the coating, then your basis will be restricted to only tablet form pills, limiting the sales figure used for a basis.

Bottom line: Spend time in choosing a basis for the royalty that reflects the value of the intellectual property to the company. Ask yourself how the licensed technology will increase the company's market share or how it will increase sales of an existing product line. Use that as a beginning for choosing a reasonable basis for your royalty.

Make certain the basis you choose can be easily determined in an audit. For instance, do not choose "profit" as your basis. There are many different ways to calculate profit for an

individual product or service. You will not control what gets amortized and applied as a deduction to gross sales. You shouldn't have to be concerned about the efficiency of the company in making the product, anyway. Thus, you should not use profit as a basis.

The gross sales are the easiest measure. It can easily be determined from Security Exchange Commission filings if the company is public. Formulas based on gross sales are next best. A fixed fee per unit is another approach, calculated once at the beginning of the contract and adjusted periodically for inflation. A fixed annual fee is yet another approach, perhaps leveraged to total annual sales.

Whatever you choose as a basis, make sure it helps the licensee to succeed commercially. Just as before, you must again be in tune with the expectations and plans of the licensee.

Tiered Structure

Reconsidering the aircraft engine example, if you were to use a unit fee for consideration in a license agreement, but the same rubber seal was to be used in several different size engines that each sold for a different price, then a fixed fee might be too high for a small engine or too low for a large engine. In such a case, you may wish to create a table of different fees for different units sold. The fee would be tiered to engine size.

There are other cases where you may wish to tier percentages as royalty rates, rather than fees. For instance, if you have a product where the initial sales will be made to so-called innovators in the market at a relatively high margin, you may wish to begin with a higher royalty, then reduce it when sales to the innovators rolls off and sales to the masses begin. Then as the product ages, prices may be reduced causing a tight, commodity-like margin in the later years of the product cycle. The royalty could be a second tier lower at that time. With this philosophy, the royalty rate may be tiered to the expected margin. This allows the business to grow and contract with its ability to generate profit.

Alternatively, the product may be entering a mature market where the price is relatively fixed. In such cases, where early sales may bear the cost of amortization of capital equipment, margins may be tight in the beginning, only to open up as the company makes a

name for itself and sales accelerate. Ultimately, you might expect that a new product will come along and supplant the existing sales, causing an abrupt end rather than entering a more commodity-like period of sales. This happens in some areas of electronics, for instance. In such cases, a tiered royalty rate that is increasing, rather than decreasing, may be appropriate.

These tiered royalty structures are often employed by the negotiator to overcome an objection to a certain proposed royalty rate. When a tiered rate structure is proposed, the ensuing discussions can teach the licensor details of the licensee's marketing plans. Sometimes it may even be revealed that plans have not been made at all.

Royalty Stacking

A new drug introduced by a pharmaceutical company may rely upon several patents from several different licensors. If each licensor asks for a royalty supported by the market rate for drugs sales, the sum of all the royalties could make the product unviable in the marketplace. In such cases, the licensee may ask for a reduction in the royalty owed to you when it must pay royalties to others on the same product (royalty stacking). This is a standard way of handling the situation in a fair and equitable manner.

Of course, it is only fair and equitable if all parties are reducing their royalties together. Be aware that you might be asked to play a secondary role, reducing your royalty while another party does not. Don't forget to ask if all others will have the same clause. As additional protection, it is common practice to reduce the royalty to no less than, say, half of the original rate.

As with the discussion on the basis, it is important to determine the value of your intellectual property to the sale of the product or service. If the patent rights are essential, then you have a much stronger bargaining position and could, perhaps, insist that your percentage of the sale not be reduced or perhaps be reduced only slightly. However, if your intellectual property is a minor contribution, perhaps you should accommodate a reasonable reduction without much discussion.

There are no absolute answers to the royalty-stacking dilemma. It is probably not possible to keep the licensee paying the same royalty rate under all conditions and still provide each licensor with fair compensation. Each case must be analyzed individually and a mutually agreeable solution determined.

Caps

Most nonprofit organizations have a responsibility to the government and the public as stakeholders. Care must be taken to ensure that they are treated fairly in a license agreement. There is often an expectation that intellectual property will generate a return that can be used to further research in some way, as in the U.S. Bayh-Dole Act.

When a licensor counter-offers a royalty capped at some figure, meaning it will not pay more than some absolute threshold, you must question the reasoning. In general, a royalty offered as a percentage of sales shares the risk of success between licensee and licensor. If the product is successful both share in the success. If the product fails in the marketplace, neither benefits.

A cap on royalties changes this premise, however. Now, only if the product is marginally successful does each party benefit. If the product is wildly successful, only the licensee benefits from the high-end sales.

When a prospective licensee demands a cap, it is a tough position to be in. It is not a partnering relationship. You will need to consider whether to walk away from the deal or whether there are extenuating circumstances that would cause you to accept the unfavorable condition.

A tiered royalty can be a solution. A windfall clause can be another. A windfall clause stipulates that, when some unexpectedly large threshold of sales is exceeded, then the licensor will receive some additional consideration, many times in the form of a lump sum. Neither of these alternatives is ideal, and they should be considered sparingly.
Consider trading this term for something entirely new. For instance, add a clause that asks the licensee to fund a chair for the principal investigator. The public relations benefit to

you may be of some value. Or, ask for a commitment for additional research funding. Adding new terms is always a good way to counter an unfavorable term.

Equity

There are cases where there is just not a good financial solution to the problem of getting a just return for the value of a licensed technology and allowing the company to make enough profit (or capital) to succeed. Take, for instance, a startup company. "Cash is king" is often the cry of a startup since it is hard to raise money and early investors want to make sure every cent of their investment is working to produce a product. In such cases, it could be possible to lower fees and royalties in exchange for equity in the company.

Equity Basis

If the licensor is to take an equity stake in the licensee, on what basis should it ask for a given percentage of the ownership of the company? Determine whether you are dealing with C corporation, an S corporation, a limited liability partnership, or some other entity. Then, determine how others have come to own a portion of the company. This will help you begin to form a basis for your request.

For a C corporation, for instance, you will want to study a capitalization table to determine how many shares are outstanding and who owns what series. Find out how many shares have been authorized by the board, since some may be held in treasury and not yet issued. It is most common to base your request on a percentage of total outstanding and issued shares in such a case.

Consider that warrants or options may have been issued that can later be converted to shares, causing you to be diluted. You may wish to incorporate those warrants and options in the capitalization table if they are not already there.

I wish I could go through each different case of company formation, but that would require several chapters unto itself. It should suffice to say here that the basis for determining a reasonable percentage to request will depend on the structure of the company, the rights held by the existing shareholders or partners, and the value of the consideration you agree to forego.

You might not make your request as a given percentage of a company, but instead ask for a number of shares of stock. In this case, you will want to establish the value of the technology you are licensing and use a price per share to convert that value to shares. Be careful. If you are dealing with a startup company, or one that has only one round of private financing, the price per share may have little relationship to the value of the company. It is best to solicit help from a colleague with experience in equity licenses.

I prefer to stick with percentages. If this becomes an issue, then consider tying the receipt of the equity to a milestone. For instance, when the company meets a certain investment closing that may already be in the works.

If you are considerably early in the life of the startup, then consider asking for an antidilution clause that keeps your ownership at a certain percentage up to the time the company receives, say, $30 million in total investment. That will keep you from being diluted in the early stages of formation, but get you out of the way when a venture capitalist comes in to make an investment.

Preferred/Common

You may wish to consider asking for a position based on preferred shares of a startup company. Preferred shares offer the owner an advantage over common shareholders, typically in the form of a position first in line for any money divvyed up upon liquidation of the company. In other words, preferred shareholders are paid back before distribution of any remaining funds is made to common shareholders.

Providing a licensor preferred shares can be an advantage for a startup company just getting under way. The price per share established for the preferred share transaction doesn't set the price per share for common stock. Thus, the company is provided with great flexibility in establishing whatever price per share it needs to raise capital without being concerned with adjustments to the licensor's position. Some nonprofits ask that their preferred shares be issued as nonvoting shares if they are concerned with the perception that they are directing or influencing the management decisions of the company.

Options

More complex structures may be considered for cases where the license agreement is negotiated prior to the issuance of shares or when the equity partners earn their way into equity positions. In such cases, you may wish to consider taking options rather than shares. Options can be structured to allow the owner of the options to purchase shares at a favorable price at some later date. It can be used as a way to provide a promise for shares without incurring the tax consequences prior to knowing the true market value of the shares.

Although most persons reading this will be working in organizations that are not concerned with the tax consequences, options are a good way to align the interests of the nonprofit licensing the technology with the corporate officers who are in charge of taking it to the marketplace. Considering options can place you on a level playing field with the founders or early investors.

Milestones

Negotiated milestones are an important part of any license agreement. They must be taken very seriously, since they can make the difference between the public benefiting from the technology being licensed or never seeing it.

Purpose

Milestones are checkpoints used by the licensor to measure progress of the licensee. In license agreements between nonprofits and industry, they are used as a measure of progress in the development of the technology. They are usually taken very seriously and can cause significant changes in the terms if missed.

They are one of the mechanisms the nonprofit can use to ensure that the industry partner is not licensing the technology to keep it off of the market. That can be a valid business strategy if the technology might compete with an in-house development, however, it does not serve the public mission of the nonprofit.

Industry-to-industry license agreements contain milestones on occasion, so your industry partner may be accustomed to the contract having milestones. However, there are several factors related to the milestones that may be unfamiliar.

Deliverables

Milestones are typically treated with a less emphasis in a typical license between two industry partners than they are between a nonprofit and industry. In the two-industry scenario, milestones may be a general indication to one party that something is getting accomplished, but they are rarely cause for termination of the agreement, should the licensee miss one. More often, they are used to complete a report to management.

As a result, the industry partner, as a potential licensee, may consider reasonable a milestone that reads, "Licensee will complete efforts to build a prototype no later than twenty-four months from the effective date of this agreement." But, if your responsibility is to make sure the public can benefit from your license agreement, then you are likely to find that unsatisfactory. It is too easy to defend that "efforts" were made to build a prototype even if no prototype was built. What you really want to know is that one was built, tested, and shown to meet some standard.

Make sure your milestones have deliverables that can be sent to you without your requesting it. A copy of an investigational new drug application or an investigational device exemption would be examples of a deliverable in the medical field. Engineering drawings or mask works would be examples in the electronics field. These documents give you some surety that the technology is truly being developed and not sidelined.

Choose your milestone in a way that meets an objective along the path to the marketplace. This can include the completion of drawings, plans, certifications, field installations, preclinical trials, clinical trials, marketing plans, advertising campaigns, or first sales, to name a few. The point is to select milestones in a manner that allows you comfort in reporting to your superior that the licensee is diligent in its commercialization effort.

Often, missing an important milestone will give the nonprofit a right to terminate the agreement. When you discover that a licensee has indeed missed an important milestone, you must decide how to best reach the public with your innovation. Perhaps terminating

the agreement and licensing it to another entity would be best. It is also possible that leaving the current license in place, but perhaps adjusting its terms would be best.

Penalty

Probably the most common kick-back in the milestone negotiation will be the severity of the penalty for missing a milestone. Often the industry partner is expecting perhaps a penalty payment. What they find in the template agreement, however, is often the right of the licensor to terminate the agreement. That may raise some eyebrows.

It is important to explain the rationale for such a harsh condition. It is the duty of the nonprofit to see that the technology has the best shot at benefiting the public. If the licensee runs into significant trouble in development, doesn't have adequate resources to make it happen, or goes off in a different product direction, then the nonprofit must have the ability to get the technology back so it may be licensed to someone who might succeed. Sometimes this means terminating the rights of a large company and licensing the technology to a niche player, who can address a very narrow market that the large company finds uninteresting.

In some rare cases, it may make rational business sense to eliminate from the license agreement the possibility of termination for a missed milestone and simply move exclusive rights to nonexclusive rights or perhaps implement a field-of-use restriction. This could occur, for instance, in a case where a professor has an idea, but has not developed it. You would like to give him or her the chance to develop it by licensing it to his or her own company, where his or her knowhow will play a crucial role in the development.

In such a case it doesn't make much sense to terminate such an agreement, since most of the concept development will take place only as a result of the license agreement. It may be unlikely that you would be able to license it to anyone else, since the knowhow is critical. Thus, you may wish to allow the professor's company to continue with nonexclusive rights or a reduced geographic area, even if he or she misses a major milestone.

Patent Prosecution

Here is where the rubber meets the road in a license agreement. If the contractual obligations surrounding the patent prosecution are not handled well, there may be nothing to work with when it comes time to enforce patent rights against an infringing competitor. Your flexibility in implementing features mentioned in this section will vary depending on your circumstances and desires.

University Prosecutes

In most licensing arrangements, the licensor (often a university) will take charge of prosecuting the patent. The licensor will own any resulting patent, so it makes intuitive sense that it controls the prosecution.

When the licensor controls the prosecution, it is typically able to choose an attorney to handle the case at will. In state institutions, this can be important, since the state attorney general may have established guidelines for preapproving attorney's representing a state agency.

You will need to consider how much control you want the licensee to have. It may ask for an obligation that you include anything it suggests to be included in the patent application. You may want to change that to an obligation to allow it the opportunity to comment and, perhaps, an obligation to consider its comments (without a promise to implement them).

The problem is that the licensee may have different objectives in the patent prosecution. I have seen some who attempt to interject a claim that would include one of its own employees as an inventor, for instance. That, of course, would drastically change the entire licensor-licensee relationship, since the licensor would then be able to proceed to commercialization without a license from the licensor.

Industry Prosecutes

The cost of speculative patent prosecution can become quite significant. Even when the licensee reimburses the cost of prosecution, the float between paying the attorneys and receiving payment from the licensee can get quite high for the licensor.

To reduce this cost, some nonprofits look to ways of having the licensee prosecute the patent applications directly. The licensee hires its own attorneys and manages the prosecution. They are, of course, prosecuting the applications on behalf of the licensor, since the resulting patent should be in the name of the licensor and not the licensee.

There are problems with this approach, however. It is quite easy for the industry partner to simply put the prosecution into the existing tracking system for the company and forget the unusual circumstance that it is prosecuting on behalf of someone else. This can lead to incorrect filing of assignments, incorrect assignee listings, and so forth.

In many cases, reporting from licensee to licensor on upcoming patent actions can be late or forgotten. This can cause degradation in the value of the resulting patent since the claims may not have the refinements of the original inventor.

Worse yet, it can be tempting to insert a company co-inventor into the process and confound the ownership of the resulting patent. This can lead to rather contentious disputes, distracting the parties from accomplishing the goal of technology development.

Still, there are cases where it makes sense to allow the licensee to prosecute the patent applications. If the technology serves a niche market and the company is the largest patent holder in that market area, then it may make sense to use the expertise its attorney has built up in his or her knowledge of the prior art. The resulting patent may be very strong, resulting in a benefit to you. This type of case may prove worth the risks outlined above. As with most of these negotiation tips, it comes down to making a sound business decision.

If you elect to let the licensee prosecute your patent application, then be prepared to place some safeguards in the contract. Stipulate that the licensee will provide copies of all attorney and patent office correspondence to you with sufficient time for you to review and comment on the material. Require approval of certain types of actions, such as adding claims, filing continuing applications, filing declarations, abandoning applications, filing appeals, and so forth.

Dispute Resolution

When two parties enter into a license agreement, they most often do so considering that they are creating a partnering relationship, one of cooperation, one of common goals. In most cases, this is exactly what happens. The university offers consultation and prosecutes the patent application. The licensee pays royalties and often funds further research. While you hope that this will be the case in all license agreements, sometimes the parties begin to disagree on the direction of the commercialization. Sometimes the relationship sours and tempers rise.

It is common in contracts between two companies to have a clause that allows the parties to attempt to resolve disputes between the two without going to court. It offers an alternative to suing each other. It most often involves an arbitrator, who is usually a retired judge or attorney who listens to both sides and offers advice.

Arbitration can be binding or nonbinding; that is, you must take the advice of the arbitrator if it is binding or agree that you will consider the advice and make your own decision if it is nonbinding. Sometimes even a nonbinding clause can lead to a solution that is much less expensive than going to court.

Public institutions typically do not accept any terms of arbitration. Occasionally, the state of which the institution is a part will have a law stipulating a specific kind of dispute resolution. Otherwise, it is most typical for a public institution to disallow any kind of dispute resolution clause. It can even require an act of legislation to include an arbitration clause.

Private institutions that resist dispute resolution clauses can sometimes accept nonbinding arbitration. To ensure that no one party has the advantage by selecting an arbitrator favorable to them, I suggest that a mechanism be established where each party selects an independent individual and the two of them select an arbitrator.

It is difficult to come up with suggested alternatives to arbitration for a general article, like this one. Check with your own institution to find out what constraints it may have on arbitration. Use your best judgment to determine a set of conditions you can live with, then set your template in a manner that allows some room for negotiation.

Conclusion

If two parties agreed on every term and condition of a template license agreement, there would be no need for negotiation. It is expected, however, that the parties are likely to see things differently and disagree on a number of points. It is important to be prepared for the most common of these disagreements and know your limits.

The nonprofit organization has different objectives than the for-profit. The need to satisfy pubic interest brings aspects to the license agreement negotiation that holds great importance, like the right to terminate on missing milestones, the control of patent prosecution, and the elimination of arbitrary caps on royalty payments.

It is also crucial that the licensee have enough flexibility to succeed in reaching the market. To make sure that happens, you will need to understand and align with the company's expectations and plans. Without that, you cannot meet your own objectives.
Ultimately each license agreement will be based upon a unique set of criteria that demonstrate success. It is up the intellectual property manager to negotiate each deal with sound business judgment to reach a license agreement that best serves the nonprofit and the public while allowing the company flexibility to succeed.