

# Moving Forward with IP: Licensing

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# Licensing of Intellectual Property

The Basics



# What is Licensing? – Definitions

- **A contract** that represents a bargain made by two parties in pursuit of their own objectives
- **Licensor** – seeks a monetary return on the investment made in creating the IP rights and related know-how on the subject matter of the license.
- **Licensee** – seeks rights of use in respect of the IP rights and know-how, on an exclusive, or non-exclusive basis.

# Licensing In – Licensing Out

- Licensing in – “the **Licensee**”
  - Motivated by a variety of needs
  - May not have resources or skill to develop technology
  - May need to access proprietary technologies
  - May be seeking a broader, strategic relationship with the Licensor
  - May be necessary to “legalize” a possible or actual infringement

# Licensing In – Licensing Out

- Licensing out – the “**Licensor**”
  - An effective way of extracting value from your IP
  - It will require an effort
    - Must identify licensees
    - Protect the technology
    - Walk the licensee through the due diligence process
    - Negotiate the license
    - Support the technology
    - Administer the agreement
    - Maintain the working relationship

# Business Factors to Consider

- When a decision is made to license, there are usually a large number of business issues that must be considered before opening or during negotiations.

# Business Factors

1. What technologies to license?
2. What rights does the licensee require?
3. Are the rights restricted to the technology, or is associated know-how required as well?
4. Has the licensor adequately protected the technology?
5. Is there more than one source for the licensed technology?
6. Is the licensee certain that the licensor has title to grant the rights that it requires?

# Business Factors - 2

7. What level of due diligence is required to minimize the risks to each party?
8. What issues need to be addressed in the due diligence?
9. Is the licensee or licensor a competitor?
10. Will the licensee be making any improvements to the licensed technology?



## Business Factors - 3

11. If improvements are made, who will own the improvements?
12. Will the licensee need technical support from the licensor?
13. If so, is the licensor in a position to give it, and under what terms?
14. Is the licensee developing into the same field, and if so, does taking a license increase or decrease the risk that the licensor will allege infringement?

# Exclusive vs. Non-Exclusive

- **Exclusive**

- Where the licensee is the only party with a right of use in respect to the IP
- If the technology is unique and the licensee wants a competitive advantage, they might want exclusivity
- But, it is more expensive and typically imposes greater obligations on the licensee

- **Non-exclusive**

- Leaves the licensee free to grant other licenses to third parties
- Licensors attempting to commercialize technology may wish to access more than one manufacturer to ensure alternate sources of supply and competitive pricing

# Right to Sub-License

- If a licensee wants to potentially **sub-license**, then it must be explicitly stated in the agreement.
- Licensors will want to be very careful about including sub-licensing rights.
  - The wider the distribution of the licensor's technology, the more difficult it will be to police the proper use of the technology, and the greater risk of the technology losing value
  - Licensors will also want to ensure that sub-licensees are bound by the same confidentiality and use covenants as the licensee

# Territory/Field of Use

- The license must state the **territory** to which the permission applies.
- Territorial reach can be mixed with exclusivity – a combination of exclusivity in one territory and non-exclusivity may suit the needs of the licensor and licensee.
- License can also be limited by **field of use**, which can be useful in cases of maintaining competitive advantage – where licensing in other non-threatening fields makes licensing more viable.

# Royalties and Compensation

- **Royalties** are payments made by the licensee to the licensor in return for the right of use.
- They can be one-time payments, periodic payments with fixed components, periodic payments with variable components, to non-periodic “benchmark” components

# Royalties & Compensation - 2

- When a licensee intends to use the licensed technology to manufacture a product, or where it will form part of a product, the licensor will be reluctant to limit its potential revenue to a one-time payment.
- In a “shrink-wrap” scenario (think software), the licensee (who thinks of themselves as a purchaser) pays the licensor a an amount and receives a non-exclusive, perpetual right to use the product.

# Royalties and Compensation - 3

- Periodic royalties are paid at defined intervals.
- May be fixed a specific dollar amount or may be variable.
  - Where the royalty payments are tied to the performance of the licensee, the licensor has an incentive to assist the licensee as much as possible to maximize their royalties.
  - Issues to consider: **variable upon which the royalty is based, royalty rate, royalty period, reporting requirements, audit requirements.**

# Royalty Variables

- **Revenue** is the preferred base for determining periodic royalty amounts.
- How is revenue calculated?
  - US or Canadian or other accounting practices?
  - Gross or net? (If net, net of what?)
  - Amounts collected or amounts invoiced?
  - Are there permitted deductions (e.g. taxes, product returns)?



## Royalty Variables - 2

- In cases where royalties are based on **number of units** sold:
  - Are bundled units treated as one unit or more than one?
  - Are units built but not sold included?
  - What about returned or defective units?
  - What about sales to affiliates?

# Royalty Rates

- Will be determined based on negotiation between the parties based on **market rates** and **bargaining power**.
- Rate may be variable, based on the amount of revenue or number of units (would typically decrease as revenue/units sold hits agreed upon benchmarks).
- May go to zero if maximum royalty payments are reached.
- On the other hand, may be increased such that a minimum annual royalty payment is reached, regardless of revenue/number of units sold.

# Royalty Period

- Licensee should ensure that the royalty period is tied into its **accounting period** to make the reporting process as easy as possible.

# Royalties - Reporting Requirements

- Licensee must deliver a **written report** to the licensor for the applicable royalty period.
- Should be part of the license agreement as an agreed-on form.
- Should set out a detailed calculation of the royalties.

# Audit Rights

- Licensors will want audit rights to ensure that the licensee's reporting is accurate.
- Licensees should be able to limit audit rights to no more than once per year.
- Issues to consider:
  - How often can an audit occur?
  - How much notice must be given?
  - Who pays for the audit?
  - When do audit rights end?
  - What happens if there is a dispute?

# Licensee's Performance Standards

- The licensor may attempt to impose **minimum performance standards** on the licensee, especially when exclusivity is sought, such as:
  - Minimum royalty payments over a period of time.
  - Minimum sales targets over a period of time.
  - Minimum levels of marketing/development resources to be applied by the licensee.
- Consequences of failing to meet standards could include:
  - Termination of the agreement.
  - Reversion of exclusive to non-exclusive.
  - Loss of some territorial rights.

# Grantback of Improvements

- If agreement is silent on product improvements, there is no requirement to disclose improvements and the ownership of such improvements will rest with the creator.
- However, it is usual that the licensor will require that the licensee “grant back” to it any improvements made by the licensee to the licensed technology.
- It is critical to define what “improvements” means.

# Terms

- The license should be for a **specified term**.
- This is often for the life of the intellectual property.
- For example, in the case of a patent, the license could be for the life of the patent.
- Or it could be for x years.



# Termination

- May be terminated by **default on the agreement** by either party.
- Or may provide either party with the right to terminate on some **predetermined notice**.
- Or in the event of the change in control of the counterparty.
- The agreement should specify what happens upon termination (e.g. can the licensee use the IP for a period of time until they can acquire an alternative?)

# Renewal

- Renewal should be considered for any license that has a fixed term.
- Can be **automatic** (unless notice is given), or can be **by right** (usually by the licensee), and needs to be exercised in writing within a certain period of time before expiry of the license.
- License should be clear as to whether all terms and conditions of the current license would apply to the renewed license.

# To License or Not?

The Innovator's  
Dilemma



# The License or Not License Dilemma

- Inventors always have a choice
  1. **License** their ideas to an existing company
  - or
  2. **Sell** the product themselves, through their own company

# Licensing

## Positives

- Lower risk for the inventor.
- Inventor can get back to what they do best – inventing.
- Financial and marketing strength and expertise of licensee can result in higher sales.

## Negatives

- Lower top-side revenue potential for the inventor (royalties are only a small % of sales).
- Probability of license may be very low.
- Success after licensing is not assured.
- Control is relinquished.

# Doing it Yourself

## Positives

- More control over the idea and its execution.
- Possibly more satisfaction as a successful entrepreneur.
- Greater top-side revenue potential.
- You are not waiting for an elusive licensing partner.

## Negatives

- Greater financial risk for the inventor.
- Inventor is usually not a businessperson – may not be qualified to run with the idea.

## Why Licensing Invention Can be Very Difficult

- An untested concept with unproven value is always worth less to a potential licensee than a concept that has been market-proven.
- We used to counsel inventors to try and manufacture and sell an initial run of the idea themselves to prove the basic concept.
- Potential licensees then have some tangible proof that the idea will sell.

# Preparing for the Process

What you need to do  
prior to negotiation



# Valuation of the IP

- The most important aspect in preparation to license.
- You need to understand the **economic value of the idea** in order to develop your negotiating licensing position.

# Three Approaches to Value

1. The **income** approach.
2. The **market** approach.
3. The **cost** or adjusted net asset approach.

# The Income Approach

- Estimates the future value of the IP on the basis of historical earnings.
- In the absence of history, licensor must develop a commercialization plan outlining:
  - Method of commercialization
  - Market
  - Demand for the asset
  - Price charged
- Then one has to develop a **discounted cash flow** estimate based on the expected lifetime of the product.
- Downside: A complicated scenario must be built, complete with forecasting models.

# The Market Approach

- The most intuitively obvious approach.
- As in valuing residential real estate, the valuator attempts to identify actual sales of similar property (“**comparables**”) for which value comparisons can be made.
- Downside: Can be very difficult to find true comparables.

# The Cost Approach

- A valuator uses to cost approach to estimate either **replacement or reproduction cost**.
- Replacement/reproduction cost is the current cost to develop similar/duplicate technology.
- Useful in situations where large companies may wish to purchase IP assets for cost plus a profit margin.
- Downside: While easiest to apply, this is often the least informative method. Costs are related to future benefits only very indirectly – it is hard to agree on what a “typical” profit margin should be.

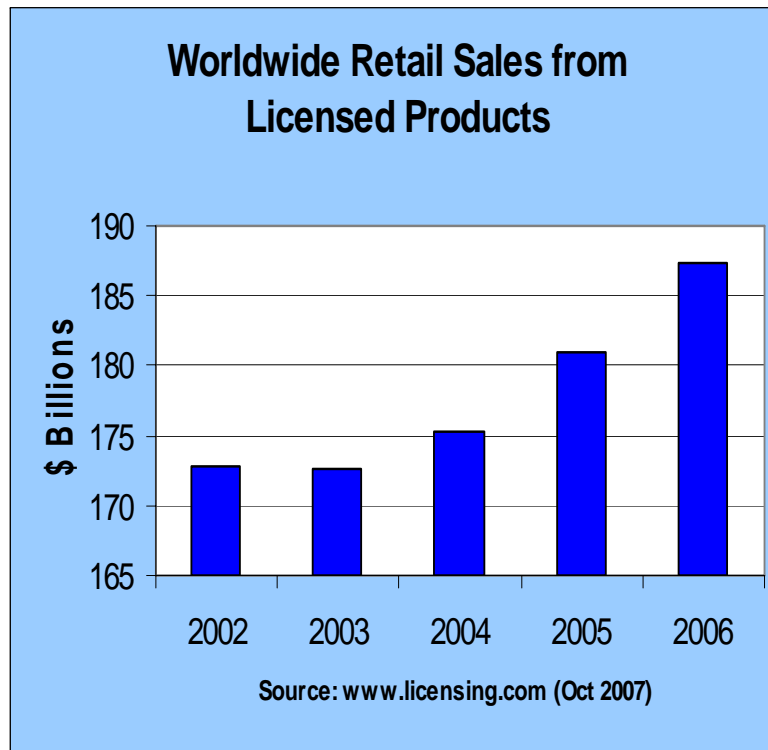
# Proper Valuation

- **Proper valuation employs all methodologies available** because they all have different strengths and weaknesses.
- Market approach provides the most direct measure, assuming a good “comparable”.
- Cost approach is easiest to apply, but assumes that historical develop costs have a relationship to future value.
- Income valuations make an number of assumptions about markets, demands, revenues, and risks, and can be very subjective.

# Savvy Merchandising of IP Rights

The Licensing Industry  
Worldwide &  
Some Examples

# The Licensing Industry Worldwide



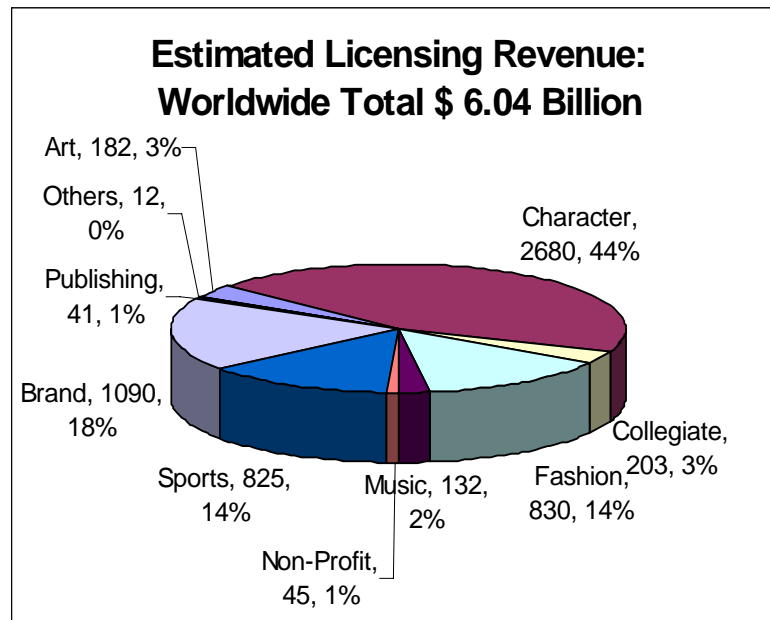
- Overall revenue from retail sales of licensed products worldwide reached \$ 187 Billion in 2006
- Licensing revenue (royalties) reached \$ 6.04 Billion
- Overall, royalties averaged 3.2% of sales



# Worldwide Licensing Industry

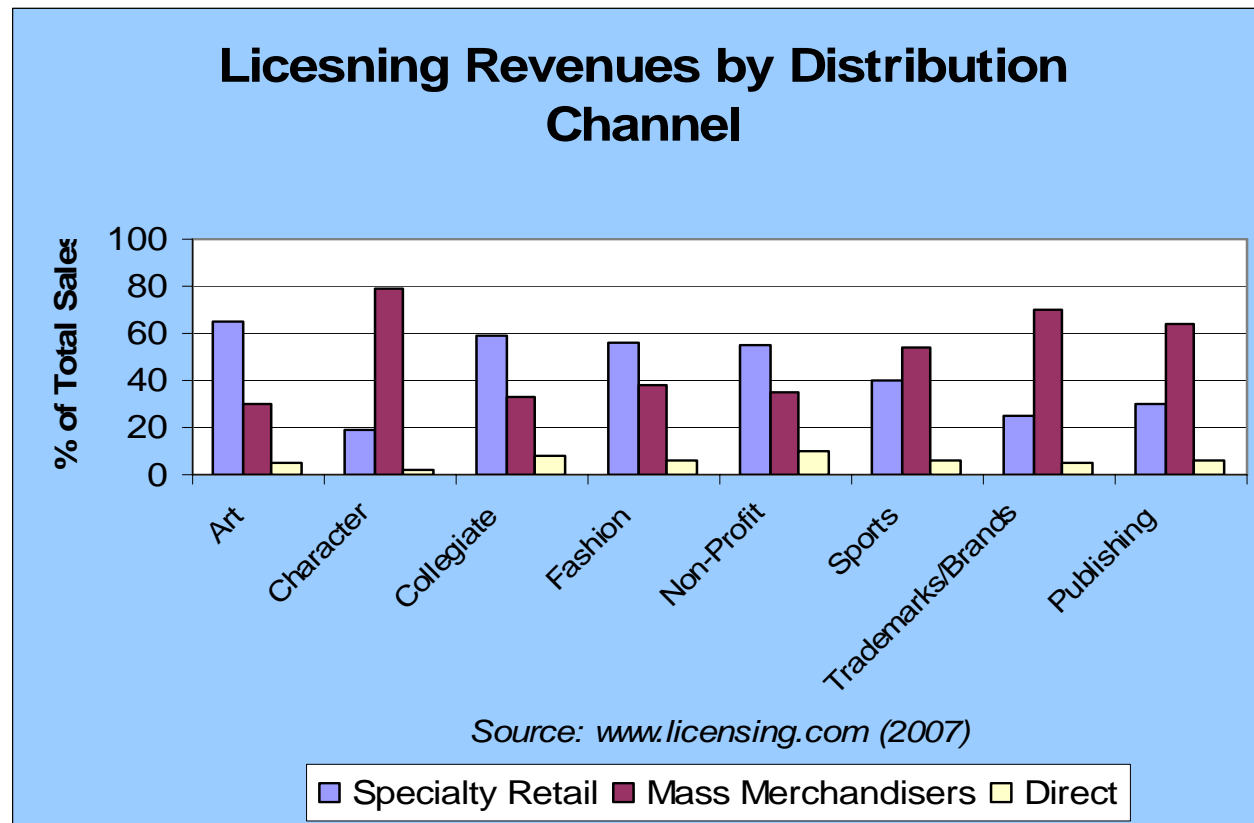
- U.S. accounts for 65% of all licensing revenues
- U.K, Germany, Japan and France follow with a combined 22%
- New and emerging markets include: Eastern Europe, China, India and Russia

# Worldwide Licensing – By Category



- Examples of character or personality merchandising include: advertising campaigns by sports stars and famous singers (J-Lo).
- Fictional characters are often derived from cartoons (Mickey Mouse, Homer Simpson)

# Licensing Revenues – By Channel



# Savvy Merchandising

- Select the right licensee – find a trustworthy and diligent partner.
- Access foreign markets – usually the licensee will be fully responsible for local manufacture, distribution etc.
- Choose the right way of representing your company – find out how competitors are positioning themselves – how do you want to be positioned in comparison to them?

# Savvy Merchandizing - 2

- Choose the right type of products – it is important to offer a range of products that corresponds to your business and the profile of your customers.
- Jointly promote the business and the merchandise – for example, print your company website on the products, promote the products on your website, enclose mail order forms with the product, merchandise online etc.
- **AND, Clearly define the right relationship and terms for the licensing of your IP in a solid licensing agreement.**

# Some Brief Case Outlines

From a Variety of  
Industries



# Case # 1 – Food & Beverage

- **Gatorade** – developed in 1965 at the University of Florida by inventor and kidney disease specialist Robert Cade.
- Looking for a way to replace the sweat expended by athletes on the playing field – sometimes would sweat off 18 lbs in a game.
- Cade realized that players were upsetting their bodies chemical balance, resulting in lower energy, strength and endurance.
- Started supplying it to the U. of Florida Gators football team in 1966 number of hospitalizations from heat stress went down from 17 in one game before Gatorade to 1 in 5 five years after the introduction of Gatorade.
- The Gators went on to an 8-2 season in 1966.

## Gatorade - (Continued)

- In 1967 one of Cade's research fellows took a job at Indiana University, where he met a VP from Stokely-Van Camp and told him about Gatorade.
- By the fall of 1967 Stokely-Van Camp had secured the rights from Cade and his fellow inventors to begin marketing Gatorade nationwide in the U.S.
- Over the next few years there were a series of legal disputes culminating in a 1973 settlement where both The U. of Florida and the original inventors , organized as the "Gatorade Trust", all received royalties.
- In 1983 Quaker Oats purchased Stokely-Van Camp



## Gatorade – (Continued)

- The Quaker Oats acquisition launched Gatorade from a “sleepy little brand into superstardom”.
- Drawing on its vast marketing resources and utilizing the talents of the world’s most famous athlete of the time, Michael Jordan, Quaker Oats pushed Gatorade to an 80% market share of the sports beverage market.
- Sales growth averaged 20% from 1983 through 2001, growing from \$ 100 million to over \$ 2.2 billion.
- In 2001 Pepsico purchased Quaker Oats

## Gatorade (Continued)

- *“Over the years, royalties from Gatorade and a host of other products has enabled the University of Florida to invest in countless research projects in a wide variety of disciplines”*
  - *Win Phillips, UF Vice President for Research*

## Case # 2 - Biotechnology

- In March 2007, Oxford BioMedica struck licensing agreement with Sanofi–Aventis for a new cancer vaccine - **Trovax™**.
- French licensor will pay English licensee up to \$690 million if all development milestones are met.
- Could be additional payments if drug wins approvals for other cancers.
- Analysts estimate potential payments could total \$ 1 billion plus royalties.
- Company will receive up-front payment of \$ 39 million – will allow company to continue development on other products – it has eight other products in its development pipeline.

## Case # 3 - Fashion

- **Mudd** – A clothing company, grew from \$ 100 m to \$350 m through licensing of products like shoes, tops, handbags and watches.
- Finding a partner that can understand your vision is key. The proper partnership expands your geographic reach and helps to develop your brand into a lifestyle brand (high awareness & association).
- Licensing in this sector can have its pitfalls:
  - The wrong licensor can take a brand into the wrong channels, ones not fitting to its name or reputation
  - Or, if product is not shipped to the retailer on time, the brand name is at fault, not necessarily the licensor

# Questions and Discussion

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