

Law Office of Stanley B. Kay

70 Walnut Street

Wellesley Hills, MA 02481-2102

Telephone: (617) 928-3677 • Telecopier: (617) 249-1527 • E-Mail: stankay@kaylaw.net

Web Site: <http://www.kaylaw.net>

M E M O R A N D U M

TO: Clients and Friends of the Firm

FROM: Stanley B. Kay

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SUBJECT: Licensing Issues

Before entering into a license agreement, you will be well-served if you pause to consider your business strategy underlying the license, and to ensure that terms and conditions of the license agreement are drafted by your lawyer to reflect those fundamental considerations.

The attached is a brief summary of significant issues that you should consider as a licensor or licensee before proceeding to negotiated a license agreement. I hope that you find it useful.



Enclosure

NEGOTIATING ISSUES

- 1. Permitted Functional Uses**

Broad or narrow definition? A typical full scope for a manufacturing license would be: use, manufacture, modify (including enhance, correct or improve), distribute and market, sublicense to third parties. Consider whether the prospective licensee will expect some role in this scope (e.g., some manufacturing or marketing/distributing) which would compromise the licensor's full use.
- 2. Technology**

Present and future patents only; or, is there also Know-How that should be included? To include Know-How will presume an ongoing technical collaboration between the licensor and licensee.
- 3. Markets**

What demographic and geographic markets does the licensor want to grant to the licensee? Does the licensor want to give the licensee a broad market scope, or only selected ones? Are the licensee's geographic and territorial interests worldwide, or are they limited to certain areas? (The broader the geographic scope, the more extensive and expensive will be the patent protection that a licensor will assume, unless it can persuade the licensee to assume those costs).
- 4. Improvements-Enhancements**

Will improvements and enhancements by either the licensor or licensee be included in the scope of the license? If the licensee is to have a future development role, will you need to establish some revenue sharing with the licensee to reflect its efforts ?

Additionally, if a licensee will make additional improvements, the licensor should ensure that they will be licensed back (i.e., "grant back") to the licensor. The terms and conditions of such grant-backs can be as extensive as those for the original license grant.

5. Exclusive or non-exclusive?

Regardless of the scope of the fields of uses and the geographic scope, is it necessary to obtain a fully exclusive license? Alternatively, "hybrid" solutions might be: (i) to give the licensee an exclusive license for a defined period of time necessary to develop its market (and recover its investment), after which it could revert to a non-exclusive license; or (ii) to give it an exclusive license for specific fields of use and geographic areas, but non-exclusive in all other respects.

6. Performance Goals

It is important for the licensor to establish performance goals for the licensee to ensure that its royalty prospects are real and not illusory. Minimum performance conditions might include: (i) the achievement of certain revenue and market share milestones; (ii) the completion of technology development (and the expenditure of defined sums for that purpose), and the perfection of patent and other intellectual property rights (if that is assumed by the licensee); and (iii) the establishment of a certain number of distribution channels (e.g., dealers and agents).

7. Royalties: basis of measurement

Potential numerical measures of performance or use could include: (i) a percentage of the revenues derived from the gross or net sales price of products sold, or (ii) a fixed amount per unit sold; or (iii) a percentage of the gross or net profits from the products sold. If there is still development expenditures and effort required by the licensee to perfect the technology and develop the market, it may be in the licensee's interest to tie royalties to profits rather than sales. The disadvantage, of course, to the licensor is that it would put more control in the hands of the licensee and its accounting practices, unless careful wording is included on how profits are to be calculated. In such as case, the licensor may want to hedge

its bets by tying such a profit measurement to an up-front lump sum payment (which might be credited against future royalties).

Alternatively, the licensor might consider a fixed royalty based on units manufactured and sold, which would shift the risk and benefits of marketing efficiencies to the licensee, since the royalty is fixed while the sales price may vary upward or downward.

8. Royalties: vary to scale

Whatever measurement for the royalty is used, the parties may want to consider varying the royalty rate (if not fixed) in relation to the level of use or performance. For example, the licensee may wish to have a lower rate initially to enable it to more readily recover its investment (especially if it pays licensor a up-front lump sum) up to a certain level of sales or profitability.

9. Royalties: minimum/maximum

The licensor may want a minimum royalty to ensure that the licensee will have an incentive to exploit the technology (which may be in conjunction with the performance milestones discussed above).

On the other hand, the licensee may want to seek to limit the maximum amount of its royalty payments to licensor. This could be based on a specified sum of royalties paid to it (and in any event at the expiration of any patents).

10. Lump Sum Payments

The licensor may want to ask for the payment of a lump sum by the licensee at the beginning of the license to meet certain near-term cash flow requirements. The parties should discuss the amount; and they should also decide whether the licensor or licensee will have to make further investments in technology development, patent perfection and market development as leverage to possibly: (i) increase or restrict the amount of the lump sum; and/or (ii) increase or restrict the royalty rate unit of measurement; and/or (iii) increase

or restrict the level of any maximum royalty level.

11. Term of the License

The term should extend until the last patent rights have expired. However, if trade secrets ("know-how") are also involved, then the licensor may seek to extend the life of the license beyond the patents' expiration. However, the licensee may also wish to discuss whether it will want the right to terminate the license earlier if it decides not to exploit the technology, or if its exploitation becomes unprofitable. (This may be useful privilege if the licensor demands a minimum royalty).