

Key Terms in a Licensing Agreement

Forms of Payment and other Financial Terms

Forms of Payment

- Royalties
- Lump sum
- Initial fee or licensing fee
- Installment payments
- Combinations

What is a Royalty?

- A form of payment in which Licensee pays value to Licensor over a negotiated period of time, in return for Licensor's consent to use IP.
- Royalties are based on volume (per unit) or a percentage revenues of products using the IP.

Why Royalties are Used

- A way of distributing payment of value to Licensor so as to:
- Permit sharing of benefit
- Share risk that the technology will not succeed (because of technology defect or market failure)
- Avoid immediate high cost to Licensee
- Ensure mutual motivation to make technology succeed.

Form of Payment: Royalty Base

- The basis for royalty calculation when royalties are on revenues: Net or Gross?
 - Percentage of the Net Sales Price (defined as gross sales net of freight, shipping handling, rebates, insurance) (e.g. 10% of Net Sales);
 - Fixed % of Gross Sales Price advisable in order to avoid disputes about deductions from royalty base.

Form of Payment: Royalty Base

- What is the product on which the royalty is measured - the whole device, only a part?
- Royalties generally may not be based on product that does not contain the licensed IP.

Royalty Variations

- Ramping (increasing) royalties
 - Declining unit sales >> higher royalty rate to keep income to licensor constant.
- Declining royalties
 - the reverse of above;
 - where value of technology is declining.

Minimum Royalties

- Important for licensor in exclusive licenses as security in case of failure of licensee to exploit the technology;
- Absolute payment obligations? Risky for the licensee--can run it into insolvency if the technology is not successful or if the minimum is too high;
- Trigger for option to terminate or modify contract.

Royalty Variations

- Capped royalties
 - Cap royalties over term of agreement to a fixed amount/avoids windfall,
 - Licensor does not like as it limits upside,
- Premium for high performance (bonus),
- Advances against royalties (where licensor needs up front cash to fund operations).

Other Royalty Issues

- Separate royalties for patents and know how (e.g. trade secrets) or other IP in case patent is invalidated;
- Do not confuse royalties with initial license fees, development installment payments, consulting payments, etc.

Financial Terms: Warranties & Indemnities

- Product warranty--who will assume liability if a customer or purchaser sues for product defects or failure to perform to specification (e.g. pharmaceuticals, software)?
- Indemnification--who bears risk of third party claims for infringement?
- This is negotiated and is a financial term.

Other Financial Terms: Warranties and Indemnities

- Generally non-profit and public institutions do not agree to indemnify because they have a public trust.
- Indemnity by small party not worth much so as a practical matter consider the assets of the party you are negotiating with.
- Often indemnity is capped at a fixed sum or at total amount of royalties paid.

Other Financial Terms: Audit

- Define audit team in case of royalty disputes;
- Specify record keeping and reports that must be kept;
- Establish range of error that triggers audit;
- Access to records needs to be practicable;
- Penalties for licensee who avoids royalties by developing alternative technologies.



Thank you !