

# Course: Intellectual Property Law-Cambodia

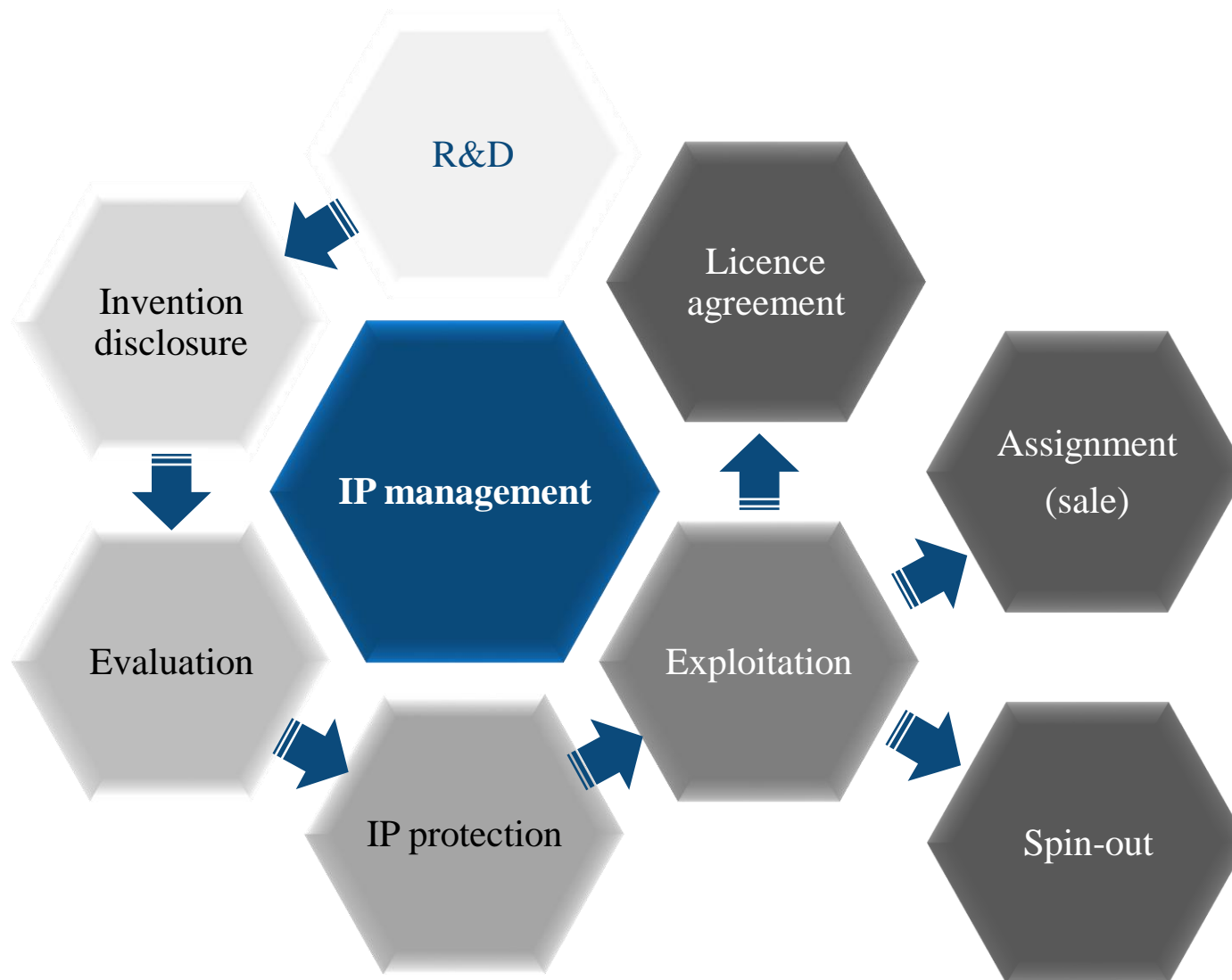
Lecture 11: Assignment and Licensing of IPRs

Lecturer: PHAN Daro

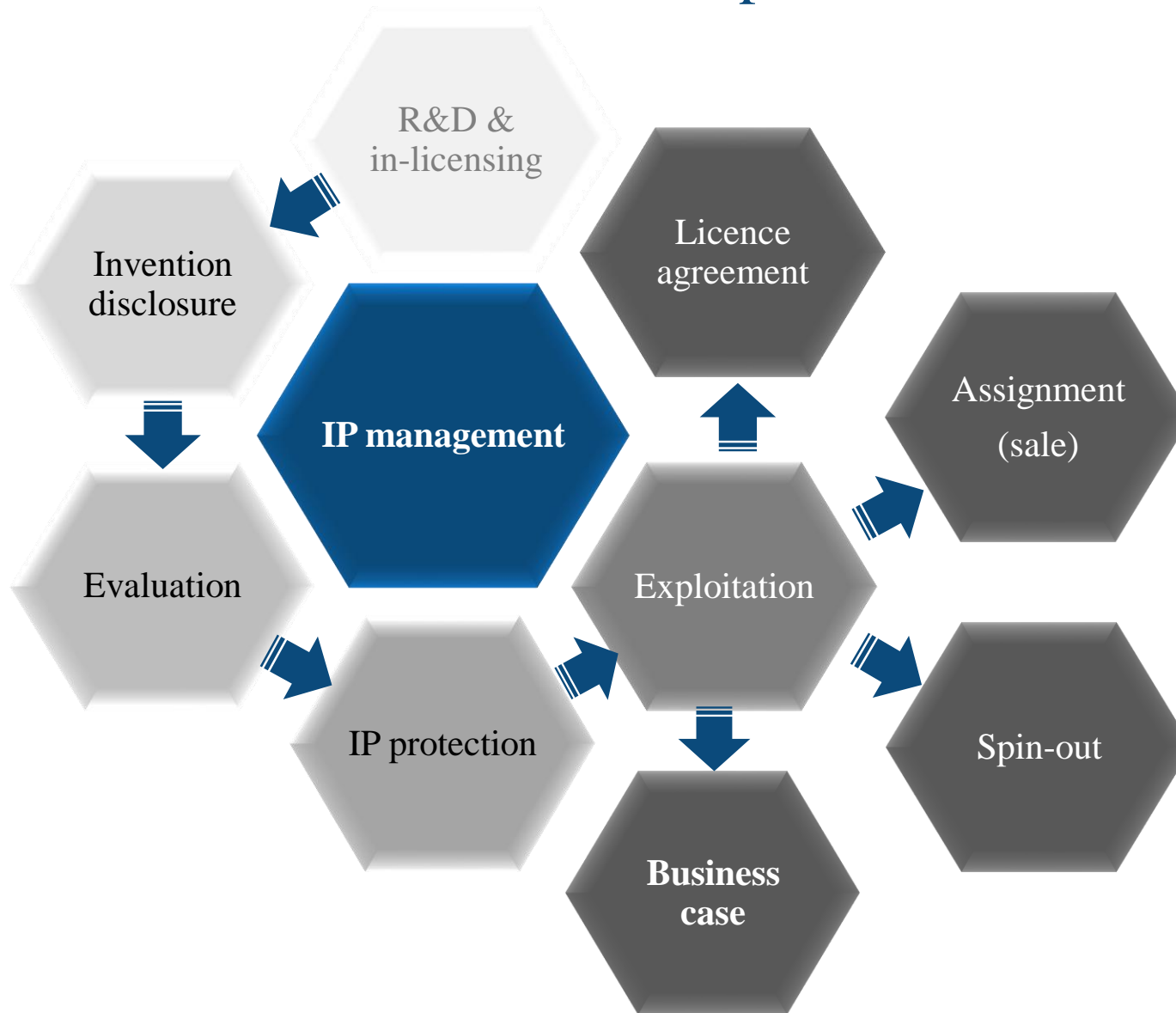
[darophan@puc.edu.kh](mailto:darophan@puc.edu.kh)

# COMMERCIALISATION OF IP

# How universities can exploit IP



# How businesses exploit IP



Broadly speaking, **technology** refers to end products of scientific research and development in the form of inventions and know-how which are used as tools or processes for creating new or improved products and services that better serve the needs of the market.

**Assignment:** the ownership rights for that technology pass from seller to buyer and it is a one-time activity. The technology is bought or sold for an agreed price.

**A licensing agreement** transfers from the licensor to the licensee the right to use the intellectual property in the technology and to make, use and sell products embodying the technology, in a **specified manner for a specified time in a specified region.**

# Why licensing?

Ideas, innovations and other expressions of human creativity are converted into private property and protected by law through the intellectual property system. As property, they are tradable assets.

**Licensing**, the right granted by an owner of such an asset **to another to use** that asset while **continuing to retain ownership** of that asset, is an important way of creating value with these assets.

Licensing creates **an income source**, **disseminates the technology** to a wider group of users and potential developers and **acts as a catalyst for further development** and commercialization.

# Licensing IP

- Intellectual property rights
  - prevent others from using your inventions and creations
  
- Licences (contractual agreements)
  - allows others to use your inventions and creations
  - in accordance with specific terms and conditions
  
- Requirements for a legal contract
  - mutual exchange of a bargain
  - consideration (payment) exchanged for something of value (IP)

# Benefits of licensing

## Licensor

- Create new source of revenues
- Access new territories and markets
- Influence market acceptance for technology and products
- Create production and supply partnerships

## Licensee

- Gain access to new technologies, turn-key products and processes and new markets
- Reduce or avoid R&D costs and associated risks
- Provide competitive advantage and IPR protection
- Increase asset value of business

# Preparing to license technology

## Due diligence:

the process of gathering **as much information as possible** on the potential licensor or licensee, the technology and other similar technologies available in the market or being developed, the market, the legal and business environment (local or international, as the case may be) and any other information that would enable the potential licensor or licensee to be better informed.

The technology sought to be licensed may be protected by one or more *patents*, subject to *copyright* and/or may have been kept as a *trade secret*

# Valuation of technology

## Cost Approach:

The licensor's investment in the technology is represented by those costs associated with developing, protecting and commercializing the technology.

They represent the base, or minimum that the licensor will want to recover, with interest

If however, for example, the license is non-exclusives and/or there are separate territorial rights, the licensee could argue that the recoupment of the licensor's investment should be borne by more than one party.

Sometimes the cost approach is used to estimate all the costs that would be incurred if the licensee were to obtain, from a different source, technology that could deliver an identified process or product.

# Valuation of technology

## Income Approach:

The income approach to valuation involves making educated guesses (or more precise measures, if possible) as to the amount of income that the new technology will generate. The issue then is to determine the respective shares the parties should each have of the benefits and find a royalty formula that matches that calculation.

### The "25% rule"

If a new product is expected to sell for **US\$1,500**, and all costs total **US\$750**, there will be an operating profit of **US\$750**.

Of this, 25% is **US\$187.50**. This is the amount, according to the "rule", the licensor should receive, and could be a starting point for further negotiation having regard to the above risks and royalty variables and any other relevant factors

# Licensing agreement

The license agreement is a contract. This means that the legal requirements for a binding and enforceable contract are necessary.

These include that **the parties** have the legal capacity and **the intention** to enter into a contract, that there is **offer and acceptance**.

The feature that distinguishes a license agreement from other agreements or contracts is that the **subject matter is intellectual property**, which the licensor grants the licensee the right to use

# Licensing agreement

There could be situations where both parties own intellectual property of interest to the other and have the legal right to prohibit the other from using it.

In such a case, they would enter into **a cross license agreement** through which they would license each other the right to use and exploit their respective intellectual properties.

**Cross licensing** is also used to enable enterprises to settle intellectual property disputes. There may or may not be royalty payments, depending on the value attributed to the intellectual property owned by each party

# Licensing agreement

Many license agreements involve a combination of one or more types of intellectual property rights.

For example, a license of patent rights supported by manufacturing know-how is often called a "patent and know-how license agreement." A license may include the right to use a trademark along with rights to make, use, sell, distribute and/or import a patented invention.

# Subject Matter

The subject matter of a license agreement may include creations such as inventions, confidential information, the creativity expressed in novels, plays, movies, music, the names of goods and services, business identifiers, etc.

The subject matter is the **first main section of the license agreement** and it will have an important influence on the contents of the agreement.

It is important to include in the agreement one or more clauses superseding the **confidentiality agreement** entered into prior to the negotiations.

These can be owned and protected under intellectual property laws, which, to reiterate, include **patents, utility models, trade secrets, trademarks, geographical indications, industrial designs, topographies of integrated circuits and copyright**, as well as those that protect against certain types of unfair competition.

# Subject Matter

A license agreement involving computer software:

- clauses specifying the permitted use or application and requiring confidentiality to be maintained.

A trademark license agreement:

- controlling the proper use of the trademark in advertising and marketing,
- maintaining the quality of the product or service bearing the trademark
- So, trademark license permits the access to samples, to inspect and the like. licensor to have a

# Extent of Rights

- The **second main section** of a license agreement relates to the **extent of the licensed rights**
- This refers to the scope of the right being licensed, whether the license is **exclusive, sole or non-exclusive** and the **geographic territory** for which the license is granted.
- The scope might also include **improvements** made to the technology during the license and will include **the duration of the agreement**.

The nature of the rights being licensed depends on the subject matter:

- For a patent, this would normally be the right to make, use and sell a patented product or use a patented process
- A copyright license may also include the right to reproduce, display, modify and distribute

Some licenses permit the licensee to "**sub-license**" some or all of the rights conferred in the license, thus permitting the licensee to go into the business himself of licensing the technology

# Exclusive, Sole, or Non-exclusive

- A **non-exclusive license**, where the licensee is one of several licensees with whom the licensor has entered into agreements for the use and exploitation of the technology
- An **exclusive license** usually describes the situation where the rights granted to the licensee even exclude the rights of the licensor in the territory
- A **sole license** usually describes the situation where the licensor as well as the licensee can use the technology in the territory, but no one else can

This distinction can be blurred in practice and the term **exclusive** is sometimes used to mean what is really a **sole** license.

It is important to ensure that the agreement contains appropriate incentives and/or penalties to protect the licensor in the event of **non-performance by the licensee**

# Example

## Example 1 - Exclusive license

Licensor hereby grants to Licensee, subject to the terms and conditions of this Agreement, an exclusive worldwide license under the Licensed Patents and Know How, to manufacture, use and sell Licensed Products for any and all uses.

## Example 2 - Exclusive license to become non-exclusive after five years

Licensor herewith grants to Licensee an exclusive license for the manufacture, use and sale of the Licensed Products.

The License will have an exclusive character during the first five years starting from the date of this Agreement. At the expiry of this time- period, and for the same territory, the License will be non-exclusive.

## Example 3 - Non-exclusive license

Licensor hereby grants and Licensee hereby accepts a non-exclusive license in each country of the Licensed Territory under the Licensed Patents to produce, have produced, to manufacture, have manufactured for it, to use and or sell Licensed Products.

## Most favored licensee

Where the license is **non exclusive**, the licensee may wish to include in the agreement a **most favored licensee clause** which in effect ensures that in the event that the licensor grants another licensee terms that are more favorable, then, by virtue of this clause, the present licensee would be entitled to terms as favorable as had been granted to the other licensee.

# Example

## Example 1

Licensor agrees that it will not issue any license granting the right to sell Licensed Products covered by the Patents to the general public, to any person, firm or corporation under terms and conditions more favorable than those granted to Licensee hereunder without giving Licensee the benefit thereof as of the date on which such more favorable terms and conditions shall become effective. In the event that Licensor enters into any such more favorable license, Licensor will promptly notify Licensee to that effect and offer Licensee a reasonable opportunity to accept all such terms and conditions.

## Example 2

If an agreement is concluded by the Licensor with any third person in [specified country (countries)] on more favorable terms and conditions than those of [this Agreement] [the Articles on royalty rates], the Licensee shall be entitled to have the terms and conditions of [this Agreement] [the Articles on royalty rates] modified as of the earlier date on which such other person conducts operations under such favorable terms and conditions to the same extent as those granted to such third person.

# Territory

The extent of the license also refers to the **geographic territory**

For example, worldwide rights could be granted, or the rights could be for specific countries or even specific parts of countries (such as a state or region of a country)

It is quite common for a licensor to operate in its local market while licensing companies active in various foreign markets to handle those markets

## Sub-license

The licensee particularly if the licensee has an exclusive license, may wish to have the right to grant sub-licenses in its territory.

If so, this needs to be specifically negotiated and stated in the agreement.

It should also be stated if the licensor's prior written approval is required for the granting of any sub-licenses, the choice of sub-licensee and the conditions upon which such sub-licenses may be granted.

For example, the extent to which the terms of the sub-license should accord with those of the head license agreement. An additional clause should state whether or not the sub-license comes to an end when the head license is terminated or expires for any reason.

# Improvements

When dealing with improvements, also known as **versions**, **enhancements**, and **new models**, it is important to define what is an improvement and, therefore, covered by the license, and what is a new technology or new intellectual property.

**Improvements** to the licensed technology are not likely to be a major issue where the licensor is in successful commercial production.

Where, however, the licensor and/or the licensee is involved in ongoing research and development, or the licensed technology is at an early stage of development, it is likely that improvements will be made to the process or product during the term of the license agreement

# Technical Assistance

Depending on the kind of technology being transferred, there is often an agreement to provide **the licensee with technical assistance** in the form of documentation, data and expertise.

# Term

The **term** or **duration** of the license agreement can be influenced by the subject matter of the rights being licensed.

A patent license could end on the expiration of the last to expire of the licensed patents.

A know-how or trademark agreement might be for five years, extended automatically for the same period, unless one of the parties gave prior written notice of termination

The term of a technology license including rights to patents, copyright, trademarks, and industrial designs will depend on the market and revenue estimations of the parties.

## Financial Considerations: Lump sums

**Lump sums** are payable on the happening of a particular event. There may be one sum only, payable on signing the agreement. If there were no further payments, this would be considered a **fully-paid-up license**.

On the other hand, there could be **a series of lump sums**, payable on the occurrence of **specific events**, which might be **time-based**, such as on the first or second anniversary of the signing of the agreement.

Events can also **be performance-based**, such as on the **disclosure of confidential information** or on the **commencement of commercial production**.

In the pharmaceutical industry, these "**milestone**" events could be the commencement of Phase I, II, and/or III clinical trials and the granting of regulatory approval.

An event could also be **the exercise of a right or option** such as the licensee extending the license to additional geographical territories or fields of use.

**Time-based payments** are certain in that the amounts are known and agreed, and they are risk-free in that they will be paid when the **specified period has elapsed**. No further action is required by the licensee or the licensor.

**Performance-based payments**, on the other hand, depend on the occurring of certain events, such as the first commercial sale. As the payments are not made if the event in question does not occur, it is important to clearly define events such as first commercial sale.

# Royalties

**Royalties** are regular payments to the licensor, which reflect the use of the technology by the licensee. Royalties are the most usual type of payment in license agreements.

Royalties have two key components: **the royalty base** and **the royalty rate**.

The **royalty base** could be the **cost of manufacturing** or the profit from selling the licensed products.

The royalty base could be the **licensees sales**. This could be the number of units of the licensed product sold with the licensee paying a fixed amount of, say, US\$1 per unit.

Alternatively, the royalty base could be either **the gross or the net sales receipts of the licensee**.

## The royalty rate

- Too high a rate can mean the license is unprofitable for the licensee
- Too low a rate can mean the licensor does not receive an adequate return, which might lead to reduced expenditure on continuing research and development
- Either might adversely affect the relationship between the parties and the success of the agreement

# Royalty variables

One possible variable is that the royalty rate reduces as the volume increases or time passes. Thus, a royalty rate of 10% might reduce to 7.5% after the sale of one million units, then to 5% after five million units. This might be on an annual or a cumulative basis.

The reverse is also possible, with the royalty rate increasing as the volume increases.

## Royalty variables

Another possible variable is that the licensee is required to pay the licensor an annual minimum royalty. Thus, the sum of US\$50,000 might be payable for year 2 of the license, increasing to US\$75,000 for year 3 and US\$1 00,000 for each year thereafter. This is particularly appropriate where the license is exclusive and the licensor needs to ensure that minimum royalties are received. If they are not, the licensor needs to be free to work with another partner so that his technology and intellectual property rights are not wasted by poor exploitation.

The reverse is also possible, and instead of there being a continuing annual minimum royalty, the license can become "paid up" or royalty free. This would happen when an agreed event occurred, such as, for example, fifteen years of commercial production and/or total royalties paid reaching an agreed total sum, whichever event occurs first. This has the objective, after the licensor has been substantially rewarded, of ensuring that the licensee is rewarded as well.

# Inflation

The issue of inflation is effectively provided for where the royalty rate is expressed as a percentage of sales. Where, however, the royalty is a specific amount in a specified currency, it is usually reviewed regularly, say, annually or every two years, and adjusted, if the national law so permits, in accordance with an agreed consumer, manufacturing or other local index.

Adjustments can also be made to lump sums payable on the happening of an event where, in particular, the occurrence of the event is distant and uncertain.

# Infringement

There are two situations where infringement could occur.

The first is where a third party is using the protected technology but does not have a license. Here the licensee is facing competition and is likely to be at a financial disadvantage as the infringing competitor is not paying royalties.

The licensee, particularly if he is a non-exclusive licensee will expect the licensor to take steps to deal with the infringement. For instance, the licensor could negotiate with the third party so that it becomes a licensee. If this is not appropriate or is not successful, then the licensor may need to take legal action.

Until proceedings have been instituted, the license agreement might provide that the licensee has the right to pay royalties into a separate bank (escrow) account, which are paid to the licensor when proceedings are instituted. If, however, proceedings are not instituted within, say, three years, then the accrued royalties could be returned to the licensee and, thereafter, the license could be royalty-free.

# Infringement

The second infringement situation is where a third party claims that the licensee is using technology in respect of which the third party has obtained protection.

In this situation, the licensee may be faced with the prospect of not being able to continue to use all or some part of the licensed technology. Again the licensee will look to the licensor to provide support and assistance.

However, the licensor might argue that it is the licensee who has control over the application of the technology and that, in any event, before signing the agreement and commencing production, the licensee should have carried out the relevant searches, which would usually have revealed the presence of these pre-existing rights.

Even so, the license agreement might provide that the parties would ascertain whether it is possible for the licensor to provide non infringing technology. If not, the issue is whether the third party's patent is valid, and, if so, the licensee might require the licensor to obtain a license from the third party and a consequent adjustment to the financial arrangements between the licensor and the licensee.

# Product Liability

Product liability can have important financial consequences. The risk is that there might be injury or damage, to person or property, arising from a licensed product that is defective. The need is to identify the source of a potential defect and to assign responsibility accordingly.

Thus, the licensee would usually be responsible for any manufacturing defects or for inadequate quality control. The licensor may supply components to the licensee, and, in this event, the licensor would usually be responsible for any defects in those components.

The party accepting responsibility would also provide the other party with an indemnity against any claims by a third party for loss or damage. The value of this indemnity is completely dependent on the financial resources of the party giving it. Thus, it is usual for the license agreement to require that product liability insurance indemnifying the licensor and licensee for an agreed value is obtained and maintained.

# Representations and Warranties

**Representations** and **warranties** are statements or assurances about a matter or position relevant to the license agreement.

A representation is not usually a term of the agreement, whereas a warranty is a contractual term, the breach of which could entitle the injured party to terminate the agreement and sue for damages.

# Licensor and Licensee Obligations

The licensor is expected to take, for example, in a patent and knowhow agreement, all necessary action to transfer the technology and assist the licensee to commence commercial production.

Similarly, the licensee is expected to successfully manufacture and market the licensed product in the territory.

In practice, this is an area that could give rise to a lot of disputes.

# Waiver

A **waiver clause** in a license agreement means that a party does not lose its rights because it does not enforce those rights.

Thus, if a licensor was entitled to give notice of termination due to nonpayment of royalties, but overlooked or ignored the breach, the licensor could still give notice in respect of another breach of that obligation.

The waiver clause in effect prevents the application of the legal concept of estoppel, i.e. the earlier tolerance or oversight does not prevent the licensor from subsequently enforcing its rights.

# Force Majeure

A **force majeure** clause in a license agreement addresses intervening circumstances beyond the control of a party, which prevent that party from carrying out its obligations.

War, strikes and fire are the types of occurrences envisaged, and the benefit of the clause is that the time to carry out an obligation may be delayed until the force majeure circumstance ceases or is removed

# Anti-competitive Practices

When entering into a licensing agreement it is important to keep in mind that if certain business practices are incorporated, the agreement may, depending on the national laws of the country or countries in question, be considered illegal if tantamount to being **anti-competitive**.

Some examples of practices:

- obliging a licensee to accept certain products or services in addition to the proprietary technology (tie-in, bundling),
- prohibiting the licensee from dealing with certain enterprises,
- attempting to fix the prices of products incorporating the licensed technology, territorial restrictions, cross licensing and patent pooling

# Government Regulations

When considering entering into a licensing agreement with a foreign partner it is important to verify the existence of various government regulations that may affect it.

For example, most countries would at least require the registrations of a licensing agreement with the relevant authorities in that country but there may, in addition, be an approval process that must be followed for engaging in that kind of activity in that country.

In the licensor's own country there may be regulations that restrict or make conditional the dealing with certain technologies for security or other reasons.

# Disputes

When negotiating the license agreement, parties should be aware that disputes might arise and provide means for resolving them.

When drafting dispute resolution clauses, parties can draw from several options.

Traditionally, parties have often agreed to resolve disputes through litigation in a specified domestic court. Increasingly, however, parties opt for alternative dispute resolution (ADR) procedures, such as arbitration and mediation, or mediation followed by arbitration.

The WIPO Arbitration and Mediation Center has developed model clauses which facilitate the submission of disputes to arbitration or mediation, or to a combination of both.

# Implementing the Agreement

To ensure that the relationship is rewarding to the parties it is important that they deliver on their respective obligations arising from the agreement.

It is important that all of the obligations and how they may be implemented be clearly specified in sufficient detail in the agreement. They imply both for the licensor and licensee costs in terms of time spent and additional human resource requirements. However, they are indispensable for the survival, smooth running and sustainability of the agreement.

# Expiration and Termination

License agreements come to an end in two ways.

The first is where the term or period of the agreement expires because of the occurrence of an agreed event. For example, the term is ten years or until the last of the licensed patent lapses or expires. When these events happen, the agreement automatically expires.

The second way is that the agreement is terminated by one party before the agreement has expired.

The events that can give rise to a party having the right to terminate the agreement are usually set out in detail and relate to a failure to perform in some way and breach of a condition of the agreement.

Some examples are failure to make payments when due, bankruptcy or insolvency. While the agreement could terminate automatically when one of these events happens, it is preferable that notice is given, with the agreement terminating if the default is not rectified by the other party within a specified time.

# References

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WIPO. *Exchanging Value: Negotiating Technology Licensing Agreements*. WIPO Publication, 2010.