Boston Patent Law Association/
Franklin Pierce Law Center
Hot Topics in Licensing Seminar
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INTELLECTUAL PROPERTY LICENSING: A NEW BALL GAME

1. It will hardly come as news to you that we do have a new ball game in the field of intellectual property (IP) licensing indeed. A simple, straight-forward plain-vanilla patent or know-how or trademark license is a thing of the past or is a rare thing; instead, complex and sophisticated hybrid agreements, option/license agreements, joint venturing, corporate partnering, co-promotion or co-marketing arrangements, strategic alliances and consortium licensing a la Sematech are the order of the day.

And there are other very significant developments and trends in licensing attitudes and practices, in IP valuation, royalty setting or other quid pro quo choices, to say nothing of an entirely different antitrust climate where restrictions commonly found in license agreements are generally viewed as pro-competitive rather than anti-competitive and IP is considered property — as it should be — rather than monopoly.

2. For perspective, let me start with some reflections of mine after almost 40 years in the field about what's happened and what's happening now in the fascinating world of IP licensing and technology transfer.

It's indeed a most interesting world because for one thing it's so interdisciplinary. It mixes technology, business and law and deals with cutting-edge innovations, creative business arrangements and intricate legal issues.

One of the more memorable and challenging licensing experiences I had in my whole career was when I had to go to Australia and New Zealand to chase down an elusive invention and an elusive inventor, owner and licensor and had to come back with a signed patent application ready for filing in the U.S. and Canada because we were running up against a Statutory Bar. And I had to bring back an executed exclusive license agreement, in shape for execution by my Management as well.

The invention had to do with a bovine parturition control method invented by a veterinarian of a New Zealand dairy company and I did come back with a finished patent application and an assignment with installment payments based on net sales of the parturition-inducing product. Why an assignment and not a license? This may be Lesson No. 1. I don't recall why I prepared an assignment. Perhaps it was intuition because it was not until later that I learned of Tom Arnold's suggestion in his opus on the "Law of Licensing" that

> "what is perceived by the businessman as an 'exclusive license,' is best negotiated into the form of a patent assignment ... with rights to reversions of title if royalties are not paid ... because the exclusive license differs from an assignment only in areas... which may be better borne by the party actively in the business than by the passive transferor of the technology."

As you can see, when you are in licensing, you don't have to join the Navy to see the world. Guess who holds the record in the Guinness Book of Records as "The World's Most Traveled Passenger?" It's Fred Finn, that's who! Who is he? He is a New Jersey-based international

licensing consultant. His record by 1992: over 2000 transatlantic crossings with 687 on the Concord, 25,000 hours in the air, more than 10 million miles flown and about $6.5 million paid in airfares. (The only record I hold was flying all across the Atlantic on a standing room only basis).

3. Now you know, of course, that licensing is a very effective and civilized way of forming business relationships and transferring technology and by far preferable to infringement litigation which has become a pernicious trend and is very much on the increase.

One attorney of a big New York law firm goes around the country, giving talks at association meetings, particularly at meetings of the Licensing Executives Society (LES), on guess what topic? You won't believe this. It is "Patent Litigation and Trials: The Alternative to Licensing".

Note he means not just starting a lawsuit and then perhaps settling it but actually going through a knock-down, drag-out fight to the end in the courts. You have to understand he is with a big antitrust law firm whose business dried up when the Antitrust Division of the Justice Department went to sleep in the '80's, which forced antitrust lawyers to switch to IP litigation. And you thought licensing was the alternative to litigation because nobody wins in litigation except the lawyers, as they say.

4. Once upon a time there was little or no licensing. All product innovation had to be home-grown technology and the NIH (not invented here) factor played a big role. And, of course, there's always an innate reluctance to license because it's more rewarding to commercialize an invention than to license it.

Westinghouse until just a few years ago never licensed in nor licensed out. CIBA-GEIGY didn't do so. When they were developing a product and a patent issued to a third party that had priority so that they were not going to have a patent position, they just scuttled the project. They did not even bother to inquire about the availability of a license.

According to a talk by IBM Vice President, Intellectual Property and Licensing Services, Marshall C. Phelps, Jr., at the recent First AIPPI Forum, held at Interlaken, Switzerland, IBM nowadays, unlike in earlier times, has an open, unrestrictive, nondiscriminatory licensing policy. This has something to do with their consent decree but they would have it even "absent legal pressures", because one "can't go it alone any more." Such licensing, Phelps also believes, accelerates the pace of product development as it provides freedom of action (with less litigation) and builds "strong relationships with other companies." And licensing income, which comes from competitors, is found money that "goes right to the bottom line." Interestingly, IBM's present CEO, who came from a company which didn't license either, fully endorses IBM's new and open licensing policy.

5. Of course, in earlier days — the good old days — it was easier to come up with inventions, develop products, get governmental approval and bring them to the marketplace. The hottest product that CIBA-GEIGY had at that time, namely, Atrazine, a corn herbicide, produced 3.5

billion dollars in profits, not sales, but profits, over the 17 years of the patent life. The patent issued the very same year in 1959 when the EPA or the predecessor agency gave market approval, so there was a clear-cut 17 years of exclusivity from the market introduction of the product to the end of the patent life.

There wasn't any licensing to speak of years ago because everybody could produce and generate enough products in-house. Nowadays you can't do that because too much money that used to go into inventive activity from which you got patentable inventions goes into non-inventive activity like toxicity studies and field or clinical trials and all that. That is necessary. We know it's necessary but millions of dollars go into that and not into basic research where inventions are generated. So you just can't rely on your own capability to fill the product pipeline, the lifeblood of any company, so you've got to go out and license in.

In this day and age, easily ten years go by, ten years of the patent life, before one can get market approval to bring out products in the agrichemical/pharmaceutical areas. And commercialization lead times are much longer in other areas as well for example, in electronics and aerospace, 5-15 years; in machine tools and automotive, 10-20 years; in energy, 15-20 years.

So there's been a tremendous change in the basic attitudes towards licensing and the need for licensing. There was none before and even though one can trace licensing back to before the turn of the century, these were special situations — interlocking situations, patent squabbles, etc., like we have now in biotechnology. Everybody has been doing the same research more or less which leads to overlapping inventions. And patents are coming out that are interlocking, and blocking. This is a settlement situation for the most part rather than a straight-forward licensing situation.

6. Furthermore, years ago it paid to infringe someone's patent. The only downside risk was damages that would amount to what a reasonable royalty would have been. There were hardly any injunctions that courts handed down in patent cases. Most of the time patents were invalidated. That, of course, has changed completely. It's a new ball game now, indeed. This is the golden age for IP. IP is now worth something. In fact it is so popular, glamorous, sexy that even our first lady, Hillary Clinton, was billed as an IP lawyer, according to Associated Press releases in 1992.

Nowadays, courts read the riot act to infringers. Patents are upheld much more often and, in addition, preliminary injunctions are granted and permanent injunctions issue more frequently and are not stayed pending appeals and increased damages — treble damages — are awarded when years ago there were no increased damage judgments at all. Of course, the hope was that this new climate for IP, this golden age for IP, would lead to less litigation. But what happened is that it has led to more litigation because more and more people are itching to sue for infringement of even marginal patents which they would not have done years ago.

As a matter of fact, questions have been raised whether the pendulum is not swinging too far and whether we have not reached a stage of patent blackmail. But that's another big topic.

7. On the negotiation and drafting side of licensing and technology transfer clearly a new wind is blowing, too, and LES deserves much credit for the improvement. Former practices of taking advantage of one's licensing partner (I win-you lose) have been replaced by win/win attitudes. The realization has taken hold now generally that the only viable license, one that has a future, is one that results from a win/win approach and passes the "fairness test". (Would you sign this agreement for the other side as well as for your own company?)

Well, this new climate, this new respect for IP, and the higher value of IP, does lead to new or greater incentives for R&D and other innovative activities because you know you can protect your IP and patent your inventions and the patents are going to stand up. The patents are going to be more valuable and we know that the patent system is a tremendous incentive to R&D and investments. Incidentally, according to CAFC Judge Rich, the patent system provides four incentives, namely, to invent, to disclose, to "invent around" and to invest and it is the incentive to invest which is the most important one.

And this new climate also leads to higher quid pro quos and royalties. Clearly the stakes are up.

8. Anent royalties, you have to take the nature of IP into account. The validity and the value — that is a big factor when it comes to royalties. How strong is the patent? Courts look at basic patents more favorably. And you can enforce such patents more easily. It's a big talking point in license negotiations. And, conversely, also if patents have warts or weaknesses.

Actually, while the strength — and number — of the underlying IPR's are very important, there are 100 factors — yes 100 — according to Tom Arnold's 1988 Licensing Handbook (Appendix C, Clark Boardman) to be taken into account in determining royalty or pricing a technology license. But not all are applicable to each situation. Still, this enumeration of the 100 factors is a very handy checklist for negotiations.

The nature of the license naturally is also an important determinant. Is it exclusive, semi-exclusive or sole, or is it non-exclusive? Are sublicensing rights included? Is it world-wide, hemispheric, national, regional, e.g. east of the Mississippi or only Massachusetts?

Other factors are, for instance:

— The stage of development of the technology;
— Access to ongoing R&D via grantbacks and grantforwards;
— Structure and spread of payments — front money, minimum royalties, payment schedule, etc.;
— Warranties, indemnification or hold-harmless obligations, especially vis-a-vis possibly dominant third-party patents;
— Most-Favored-Licensee clauses, etc.

Incidentally, according to Tom Arnold — and this makes sense — the cost to licensor of the development of the technology is not a factor. The public's interest in buying a product and thus the value of a technology in the marketplace is "essentially unrelated to the cost of developing it" except insofar as it aids estimation of the cost in time and money of the licensee's alternative, namely, competitive development of equivalent technology. Thus there is a limit to what the licensor can charge.

In this connection, it is important to keep in mind that it is very often the licensee's economics not the licensor's that controls the royalty determination or royalty setting.

9. Now what about royalty standards in industry? Aren't there norms in each industry to go by? This is the common belief as there are figures often being bandied about as industry averages. In a recent article on "Patents for Sale: Evaluating the Value of US Patent Licenses" (8 EIPR 385, 389, 390, 1995), John Romary of Finnegan, Henderson in Washington, called industry average royalty rates "folklore" and "suspect as a royalty-rate guide."

For example, a 5% running royalty for a non-exclusive license helps very little in evaluating an exclusive license on different, but related technology and a 1.5 % running royalty on technology

that can be effectively designed around is equally unavailing in pegging the value of a pioneer patent critical to the competitor.

However, Romary allows as how such averages provide additional data points, and he lists for chemicals 1-5%, electronics <1-5%, computers 3-5%, consumer products 2%, pharmaceuticals 4-15%. He also states that these figures are based on the net sales price and a non-exclusive license and that a "20 to 50 per cent premium" and "as much as a 300 per cent premium ... in the pharmaceutical field" may be a reasonable average for an exclusive license.

10. Given the unreliability of industry standards and the need to consider numerous factors in royalty setting, it is clear — and I stress this in my Licensing course, which I teach at Franklin Pierce Law Center — that the royalty is not the first thing but the last thing to talk about and agree upon in negotiations. Only after all the relevant factors are considered, and all the other license terms are in place, is it time to settle the money terms and these can include lump sum payments as front and/or milestone payments, running royalties, minimum and/or maximum royalties, descending- and ascending-scale royalties and any combination of the above. You can be quite creative and sophisticated about crafting a win/win licensing and technology transfer arrangement.

Another thing to be kept in mind is that when it comes to royalties less may be more and greed rarely if ever pays off.

11. Not surprisingly, nowadays licensors are often not satisfied with mere running royalty payments amounting to but a few per cent of net sales of licensed product. They prefer or insist on a more substantial quid pro quo, such as, cross-licenses under IPR's of licensees to commercialize technology or products of licensees inasmuch as more profit can be realized by manufacturing and selling products, especially when they are protected by IPR's, than by merely collecting even relatively high royalties, which, as I intimated at the outset, is behind the inherent reluctance to license.

And because royalties, both running royalties as well as lump sum payments, have gone up considerably due to the greater enforceability and value of IPR's, option agreements are on the increase to give licensees time to consider their true interest in commercializing the technology or product in question.

12. Well, here you have a few of my reflections, musings and truisms, if you will, about IP licensing and technology transfer: what it was like then and what it is like now.

Karl F. Jorda
David Rines Professor of Intellectual Property Law
Franklin Pierce Law Center