
Fifty shades of licensee: selecting the right licensees to increase IP value

In the IP licensing arena, an evolving licensing arrangement is important in order for both parties to maximise the benefits and minimise the risks of the relationship

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A contract is the culmination of a meeting of minds – mutual consent by two or more parties. In theory, the parties to a contract have the same understanding of the contractual obligations of each. However, misunderstanding and ambiguity over the definition of terms can occur, particular in the IP licensing arena. An initial term sheet – whereby what the parties believe to be the salient points of agreement are put to paper (or email) – may lead to additional, at times contentious, negotiations because of an initial lack of clarity. The licensing arrangement may begin at any stage of the licensor’s business development; however, care should be exercised depending on the particular stage. The importance of this is due to the fact that the intellectual property that is the subject of the contract evolves with the growth of the licensor’s business, and the originally cast definitions contained in the contract may need to be examined periodically and possibly modified depending on the circumstances. Thought should be given to provisions being placed into the contract that allow for amendment of the terms. Failure to do so may mean that the licensor is shackled to an unwanted licensee with little recourse for extraction from the relationship.

Assets you put on the table

A company interested in licensing its intellectual property should first know the

boundaries of those assets. An IP audit can aid in this process. Once the prospective licensor has an understanding of the financial value of its intellectual property, the company can focus on what it wants to obtain from this licensing relationship. Royalty revenue? Notoriety? Brand expansion? Market share expansion? Goodwill and reputation changes? These concepts overlap, but regardless, consideration of the company’s aspirations should help to focus the negotiation with the appropriate licensing partner. Without a thorough goal-oriented appraisal of the facts and figures of the IP assets, entering into a licence with a licensee that is not like-minded can easily have a significantly adverse impact on the value of the IP assets at issue. Assessing the value – objective and subjective – of the relevant IP rights that are going to be captured in an agreement is an essential step not only in reaching a meeting of minds, but also in initially assessing the suitability of prospective licensees. Setting expectations as to the desired outcome of the contractual obligations makes for a more likely positive outcome for both licensor and licensee.

It is common for a licensor to want to engage in a licensing relationship in order to enhance the worth of its intellectual property. It is also possible that, depending on the terms of the contract, the licensor could engage the licensee in such a manner that additional intellectual property is created by way of the licensee’s own business activities and, as such, will need to be correctly protected and safeguarded. With these observations in mind, it is critical for a business entity – whether the licensor or the licensee – to consider relevant factors in determining net value of IP rights involved in an agreement before making a

commitment. This chapter further discusses several key factors that prospective licensors and licensees would both be wise to consider before finalising their contractual duties. These factors are particularly germane to a cost-benefit analysis designed to structure the type of deal with the type of licensee that is most likely to meet your business needs.

Multiple licensing partners versus exclusivity

At the beginning of the venture and throughout the licensing relationship, the parties should discuss the benefits and drawbacks to entering into a sole, exclusive or non-exclusive licence. Much of this will depend on the extent to which the licensor is already engaged in the business in which the licensee wants to engage. For example, if the licensor does no manufacturing or advertising on its own, and is in essence only in the business of licensing, then it is a good idea to examine periodically the long-term company goals in terms of breadth of coverage of different markets in which the intellectual property may be licensed. For example, does the licensee want its name and brand and/or invention brought into retail and/or wholesale markets, adult and/or children markets, continental and/or regional markets? Will the licensor share in the profits and also compete within the licensee's contracted market? Or will the licensor receive royalties and leave the licensee to exercise a certain discretion in the volume of sales of the services or products encircling the IP rights? These considerations weigh on the issue of the level of intensity with which the parties wish to saturate the market with the intellectual property at issue.

It is possible that in certain circumstances, the greater a licensee's business depends on a licensor's IP rights, the higher value those rights entail to the licensee. Take the example of a start-up company (prospective licensee) whose product is a derivative work of another business entity's (prospective licensor) copyrighted work. The prospective licensee may be entirely reliant for revenue on a licence with the prospective licensor. Depending on the structure of the licence, the prospective licensor may not have even entertained this sort of arrangement in order to drive its own

revenue up.

On the other hand, when a prospective licensee's core business does not depend on a prospective licensor's IP rights so much as to be compelled to enter a licence in order for the business to be viable, the value-to-cost ratio changes such that the prospective licensee might decide to work around the prospective licensee rather than embrace the licence. Accordingly, the more that a prospective licensee's business depends on a prospective licensor's IP rights, and all else being equal, the higher that the remunerations for each party are likely to be.

Enforcing the rules

Another significant factor to consider before signing a licence is the respective responsibilities of each party for enforcement against infringements – both third-party infringements and possible infractions of the licensee itself. Will the licensor be responsible for actively enforcing and/or defending its IP rights? Can the licensee financially contribute to enforcement efforts, particularly since it is in the licensee's best interests that the IP rights be as highly valued as possible (for profitability of the licensee's products sold or services rendered utilising the licensed intellectual property)? This all matters because of the possibility that the apex of the deal – the licensed rights – may be exposed to challenge by third parties. If that occurs, the parties should be fully aware of the financial obligations incurred in safeguarding that which is the basis for the revenue generation for each entity. For example, a non-profit organisation may lack sufficient resources to enforce its IP rights aggressively and may rely on the cooperative efforts of the licensee(s) to aid in this endeavour. Moreover, larger licensors may have the wherewithal to enforce without the support, or despite the interference, of the licensee(s). Finally on this point, research is freely available through online databases in order for the parties to vet each other's history of enforcement efforts. It is important that these expectations be managed accurately in the terms of the contract.

Size matters

The size and stability of the market in which a prospective licensee is entangled with use of

the licensor's IP rights may be paramount to negotiations. First, greater market size and the licensor's initial share of that market could implicate a shortfall where the licensee is concerned. However, a smaller market share may mean that the licensee will be required to be more creative in marketing, advertising, promotion and distribution activities in order to make a greater impact. Further, when only a few competitors are at play in a given market, there could be less uncertainty as to ownership and validity of the licensor's IP rights than otherwise, having a direct effect on the licensee's ability to maximise profits (leading back to the licensor's ability to possess royalties or other income derived therefrom).

A saturated market – for example, where the competitive nature is that everyone is competing on improvement utility patents or thinly veiled suggestive marks bordering on being merely descriptive – can easily lead to uncertainty as to the ownership and validity of IP rights. The outcome may be an imbalance in negotiation power between the licensor and the licensee, or worse, the total failure of the contract due to third-party successful challenges or design-around competition that voids or avoids implication of the IP rights that are otherwise the subject of the contract.

An unstable market implies expanding numbers of IP rights owned by multiple entities where the rights may overlap or be related, thereby increasing the uncertainty as to issues such as validity and breadth of those rights. In this regard, the size and stability of the market in which a prospective licensee gets involved with a prospective licensor's IP rights have some bearings on the potential cost that goes into making a licence agreement. In a market that has little saturation, a potential licensor owning significant IP rights related thereto may have a good incentive to licence that intellectual property to a properly vetted licensee with the right kind of prowess to be able to extract maximum profitability in that market space.

Judgement and perspective

Many factors other than those surveyed in this chapter play into the decision to license and the negotiation of licence terms. Points that are a good basis for determining the outline of a

term sheet include:

- The gravity of IP rights in relation to the prospective licensee's business.
- The level to which either party to the contract has the means to, and will actively, enforce the encompassed IP rights.
- The size of the market which the prospective licensee wishes to enter and the stability of that market.

These factors are relevant to the extent to which each party values the IP rights and the resulting revenue that may be derived from utilisation of those IP rights. In other words, they influence the answer to the question: is this a good match? Will I, as the licensor, acquire as much as I believe I should from permitting the use of my valuable IP rights?

The same sorts of question are likely to be asked by the prospective licensee, because unless there is sufficient value in the IP rights that are the subject of the licence, the licensee has little incentive to engage in the licence relationship. For instance, the more active that a prospective licensor is in successfully enforcing and/or otherwise safeguarding the IP rights, the less concerned that a prospective licensee may be with the loss of the rights that it wants to amplify, which suggests that a licence agreement is worth pursuing. Contrarily, a prospective licensee may be less inclined to engage in a deal where its research shows that the market is getting bigger and saturated with more players. This could indicate that the expenses to participate will be higher than makes for a comfortable business arrangement.

Likewise, an unstable market could indicate the need for either party to increase the complexity of managing the involved IP rights. Increased uncertainty can frighten prospective business partners and elevate risk-averse behaviours. Since the stability of the market in which particularly the licensee is involved can evolve over time as a result of a variety of conditions (eg, government changes, regulatory changes), anticipating the economic swings in the terms of the contract to allow for a structured termination is important. The finality of the licence relationship should be examined at the outset in order to facilitate a smooth transition from one point in the relationship to another.

Conclusion

The factors examined here are neither exhaustive nor conclusive, but they are nonetheless significant components of a successful licensing arrangement in order for both parties to maximise the benefits and minimise the risks of the relationship. The idea of a 'meeting of minds' may seem simple at first thought. Both parties want the same thing: to maximise IP value and increase their respective bottom lines. However, as the market, the intellectual property involved and other factors evolve during the term of the contract, the reasons for entering into the licence at the beginning may also change. Without a well-structured termination provision, neither party may be safeguarded as well as it otherwise could be in order to prevent financial harm. *iam*



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