

BUSINESS INFORMATION SERVICES

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1 What Is a Licensing Agreement?

A licensing agreement is essentially a contract conferring on someone the legal right to use intellectual property rights owned by another person. It is used when the owner of a product does not have the necessary expertise, resources, time or indeed inclination to successfully manufacture/operate/market the particular product. The owner grants a licence to a third party who has the requisite business acumen, knowledge and experience to operate, manufacture and market the product in a certain territory on behalf of the owner of the product.

Although the licensor relinquishes the direct sale or manufacture of the product, he enjoys the benefit of still owning the intellectual property, and usually retains control over the use of same. In addition, the licensor may receive continuing royalties throughout the duration of the licence, thereby fully maximising his return. Royalty figures are usually calculated based on the number of licensed products sold. It would therefore be most advantageous for the licensor to select the licensee who is likely to make the best yield on the product.

2 Choosing a Licensee

The choice of licensee should be fully investigated before any commitment is made. The licensor should find out about any other similar ventures or, if this is a first-time venture, they should ensure that the potential licensee has a sound business plan and sufficient commitment to the project. The construction of the licence should promote proactive selling and create an incentive to boost the potential of the license.

3 Protecting your Intellectual Property

Just as a specific financial return is important, so too is the manner in which the products or trade mark will be utilised by the licensee.

In order to maintain the integrity of the product, it is necessary to protect it. If the manner of use enhances the reputation of the product, inevitably the value and marketability of any affiliated products will also

be increased and vice versa. In his protection of the intellectual property, the licensor should ensure that the licensee is using the licence in the manner in which he intended by imposing limitations and conditions on its use.

4 Are There Different Types of Licensing Agreement?

The first stage to consider, once the decision has been taken to create a licence, is the nature of the licence. It can be:

- Exclusive - where only the licensee will market/manufacture/operate the product itself.
- Sole - where the licensor agrees not to grant any other licences but retains the right to market/manufacture/operate himself.
- Non-exclusive - where the licensor can grant any number of licences and may market/manufacture/operate the product himself.

Licensing contd.

not yet be published. This would allow others to infringe upon this information and the advances made, claim them and profit from them. Other types of information which would be of commercial value, for example, sales projections and client details, should also be kept confidential to ensure that no-one is able to exploit licensed information without possessing a licence to do so.

10 Heads of Agreement

In order to clarify exactly what is to be contained in the licensing agreement and to record the commercial terms of the licence in advance, it may be useful to consider non-binding, or partially binding, heads of agreement. This should explain to both parties that if they proceed with the investment at this stage, it will be at their own risk.

11 Jurisdiction

The jurisdiction for the governance of the agreement must be stipulated and if any alternative dispute resolution is to be permitted, it should also be included. If, however, a licensing agreement involves any law outside the jurisdiction where the agreement is constructed, for example, in the case of an overseas licensee, it is necessary to consider the extent of the advice which will be essential regarding the application of local law to the proposed licence arrangements.

An extension of this consideration of multiple jurisdictions is, of course, the examination of the potential application of European Community, United Kingdom and any local laws which impact on the competition aspect of the licensing agreement. This should now include an assessment as to whether the licence will be caught by Article 81(1) of the EC Treaty. This section of the Treaty prohibits agreements which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market.

12 Taxation

Another practical consideration is the effect of taxation on any royalties earned from the licence. If the licensee is overseas, it is necessary to investigate whether or not the royalty payments are subject to withholding taxes and if there is a double taxation treaty which will enable the licensor to recover all or part of the sums withheld.

In order to combat this, a grossing up clause, which is a calculation of the amount that would be required in the case of an investment subject to tax to equal the income from that investment as if it were not subject to tax, may be necessary in the licence.

It must be borne in mind that where substantial sums of money are involved in a licensing agreement, specialist advice should be sought regarding whether

or not it would be a feasible option for the royalties to be routed through tax-favourable jurisdictions, thereby allowing the licensor to maximise their investment in the agreement.

13 How Should the Agreement be Structured?

The provisions of the agreement are similar to any other agreement. They must, however, be constructed to result in an effective licensing agreement for the licensee and to establish a profitable income stream whilst providing protection for the licensor and his product.

14 Parties

The parties to the agreement are usually the inventor or owner and the licensee. It may, however, be necessary to introduce other parties to the proceedings in order to reinforce the protection given to the confidentiality of the licensed intellectual property by joining the licensee's major shareholders as parties to guarantee the obligation of the licensee. Any additional parties, however, should only be added once consideration has been given and specialist advice sought in relation to the impact competition law would have in such a union.

15 Definitions

Precise and accurate definitions should be drafted for all terms used in the agreement. A narrow and definite drafting will ensure that advantage is not taken of a wide definition for the term "licensed product" and restricting the range of products to which the licence applies. With regard to "net sales price", a clear definition must be provided, as this is typically what will have been defined as the basis for the calculation of royalties. It must be decided and specified in the definitions, in order to avoid subsequent confusion, at what stage deductions pertaining to the licence of the product, for example delivery charges and sales taxes, should be made.

16 Scope

The scope of the licence should also be clearly defined and all the following should be detailed within the agreement:

- the nature of the licence - exclusive, sole, non-exclusive;
- the territory covered - it is best to avoid including ambiguous terms, for example, Europe and Africa, but rather specify exactly the area to be covered;
- whether or not it is for manufacture, operation or sale, or a combination;
- whether or not sub-licensing is permitted;
- whether or not sub-contracting the manufacture or operation of the licence is permitted.

