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## **Aim for long-term relationship when licensing intellectual property**

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Negotiating a license for intellectual property is like a courtship. When it works, two parties agree on a collaborative relationship that benefits both in the long term. They are clear about each others' expectations. Above all, they are confident that they've chosen the right partner.

Attorney Keith Trefry offered that and other insights at the Three Rivers Venture Group meeting in Richland last month. Trefry is a partner with the Spokane office of the law firm Paine, Hamblen, Coffin, Brooke & Miller, which also maintains an office in Kennewick.

Licensing intellectual property gives others the right to make, market and sell an invention, such as a new device or process. Typically, a patent owner will grant a license to its patented idea in exchange for revenues from future sales of the product. Copyrighted materials—such as software, website designs or literary and musical works—also can be licensed.

### **Keep the end goal in mind**

“The goal is not to win the negotiation, but to establish a fair, long-term relationship,” Trefry said. Unlike a typical sales agreement, an intellectual property license represents an enduring, collaborative affiliation where the two parties will share ongoing profits.

“Rather than squeezing out that last half-percent in royalty terms, both parties should aim for an agreement that will help them successfully commercialize the product and generate sales,” Trefry said.

### **Deal directly with difficult issues**

Before signing an agreement, be sure there are no barriers to the partner's commercializing your invention. For example, is the firm already developing a product that could compete with the new one? Does it need to sell existing inventory before it starts marketing yours? If so, there's less incentive for the recipient firm to push ahead with the new product.

Some entrepreneurs have been burned by signing exclusive license agreements with no “outs.” When the acquiring companies didn't follow through as expected, the inventors could only watch as market opportunities slipped past the stalled technologies. One strategy is to set minimum sales and royalties expected by a certain date. If sales don't meet expectations, the inventor can impose penalties or end the agreement and seek another partner.

Companies often require proof that a new high-tech product works before they'll sign a license, said John Landefeld, Chief Operating Officer of KeyMaster Technologies. His Kennewick firm developed a technology that confirms that products are authentic

and meet quality and security specifications. The technology is being used by the carpet and fiber industries and is being evaluated by NASA and other government agencies for national security applications.

“Before we enter into a license deal,” he said, “there’s usually a long evaluation period, where we’re working with their technical people to prove that the product works for their industry.” The acquiring company has to feel comfortable that the product is “ready for prime time” before it goes to the effort of developing a long-term relationship, he explained.

“Investing up to 18 months on a customized prototype before you see any revenues is a huge gamble,” Landefeld said. And once you start earning royalties, there’s no guarantee that they’ll continue, he added. “Because technology changes so fast, we’re constantly working with the license partner, providing upgrades to stay ahead of the competition.”

### **Structure royalties appropriately**

Agreeing on a profit split can be challenging. Each deal is negotiated on its own merits. One rule of thumb is that the company licensing the intellectual property gets around 25 percent of the pre-tax profits or net sales, with the acquiring firm getting about 75 percent, Trefry said. One party can get more or less depending on the efforts each commits to commercializing the invention.

It’s a mistake to expect higher royalties because of the uniqueness of the invention or the amount of research funding invested to develop it, Trefry cautioned. “There’s no inherent value in an invention or patent. The bottom line is not return on the inventor’s investment, but the return from future sales.”

High quality market research and sales projections make it easier to forecast the profits that determine the royalty rate. Things that affect profit projections are trends in market growth or stagnation, competitors’ market shares and the anticipated technological lifespan of the product.

Royalty rates are also based on the partners’ abilities to make and sell the product. Do they have the equipment to manufacture it? Existing distribution and sales channels? Potential customers lined up? An established reputation in the industry, which creates instant brand recognition? The partner who brings these things to the table can expect a bigger piece of the profit pie.

### **The right partner**

Trefry emphasized that the most important thing is to get a trustworthy partner, “not someone whose sales figures you’ll be forced to audit constantly.” Find someone whose business culture and philosophy matches yours. “You want a partner, not just someone to do business with.”