



# 10 *Must Know* Licensing Tips



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# Top 10 Features of a License Agreement

*This, in turn, gives our inventor-clients favorable terms which limit his/her future risks and investment while maximizing royalties.*

*Our years of experience have given us a solid foundation in the licensing process.*

*We're happy to present you with this guide to help you not only understand some key components of a license agreement, but also to build your own foundation for success with your invention.*

*A license agreement can be confusing when you read it over. There is a lot of content with many legal definitions, timelines and deliverables. Since our inception in 2002, our license agreement has undergone many changes. This is mainly because each license negotiation that we have been involved with brings a new perspective to the table, and we're always seeking ways to improve our own template document.*

*Some things do not change, such as our priority to provide a sound starting point to the license negotiation process.*

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# 1. Definitions

License agreements typically define key terms that are used throughout the document to ensure that there is no ambiguity. If the agreement defines a “Banana” as a motor vehicle with four wheels, then for purpose of that agreement you need to start thinking of a car in terms of “banana”. Here are some typical definitions that you will see in license agreements:

## **LICENSOR**

This is a term used to refer to an inventor, or the person/entity that is granting rights to the invention.

## **LICENSEE**

This term refers to the company or party that is going to license your invention and (you hope) pay lots of money in royalties.

## **INTELLECTUAL PROPERTY RIGHTS**

This term may refer to the patents, patent applications, trademarks, trademark applications, copyright registrations, etc.

Basically, it defines your ownership rights in your invention.

# 2. Royalty

*The top question on most inventors' minds is “Where's the money?”*

Since a majority of our agreements have based the inventor's compensation on Royalty payments (not outright purchase of inventor's assets, patent(s), etc.), let's reflect on what that means in terms of how you would ultimately get paid. A Royalty is the amount of money paid by Licensee to Licensor for the use of the inventor's intellectual property. There are different ways that a Royalty can be calculated and this can be a hotly-negotiated issue.

## **Some variations are:**

**A.** Most common in our experience, Royalty is based on a percentage of sales by the Licensee. Most often the royalty percent is in the 3% to 5% range, but this can fluctuate widely based on circumstances like patent

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status, development stage of the invention, profit margin for the Licensee, etc.

**B.** When Royalty is based on sales, it can be calculated on either “gross” or “net”, and may allow deductions for things like returns, damages, rebates, etc.

**C.** Instead of basing Royalty on sales, sometimes it is based on manufacturing cost, or even on profit.

**D.** Instead of computing Royalty on a percentage, Royalty can be based on a flat dollar amount per unit, for example, \$X per unit sold.

## 3. Advanced Payment

An advance payment is a highly desirable feature for a license agreement. But often, the licensee is not willing to offer an advance in light of the large investment that he or she is biting off by licensing. Here are just some of the expenses that the licensee may face post-license: design engineering, prototype development, tooling, samples, packaging design, inventory, warehousing, marketing/selling expenses, etc. Advance payments do

occur (trust us, we’ve seen them), but not always...and maybe not at the dollar amount that you are hoping for. Sorry, just wanted to throw in that dose of “reality” so that you can set appropriate expectations. Any advance payments would be defined clearly, along with timing for such payment, in the license agreement.

## 4. Payment Schedule and Audit

The license agreement will define the frequency at which Royalties are paid (ex: monthly, quarterly, annually), as well as any reporting that must accompany the payments. Our standard agreement requires royalty payments to be made on Quarterly schedule, and payments must be accompanied by a report showing the number of units sold, dates of sales, date of payment, and gross and net selling prices. There should also be some language to define if, and how often, the Licensors are permitted to audit the accounting records of Licensee (keep them honest).



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## 5. Territory

Are you giving the Licensee worldwide, exclusive rights to your product? If they sell only in North America, then the territory that you grant might instead give only North America rights. This must be defined in the License agreement.

## 6. Term & Termination

This can vary from one agreement to the next. The “term” defines how long you are granting the license to the licensee. Some agreements define term with a specific end-date, which might be three years after the license was signed. Other agreements, such as our standard agreement, provide a more open-ended term which will continue for as long as both Licensor and Licensee fulfill their obligations in the agreement.

Termination language should be included to give definition to both parties rights when the agreement is cancelled or expired.

## 7. Improvements

Let’s say that you license your invention, and then the Licensee transforms your product from something very “vanilla” into a tricked-out, trumped up version of itself with scores of improvements. It’s a good idea to define upfront who owns those improvements. Our standard agreement states that any improvements developed by the Licensee will belong to the Licensor. We that’s the way it should be.

## 8. Deliverables

We are firm believers that setting appropriate deliverables is the key to a happy license. It would be a tragedy if you licensed your invention to a company who then just sat idly by, making no progress at all, and you had no legal rights to cancel the agreement. Our standard agreement enlists various methods to keep the Licensees honest and accountable to a defined schedule.

**Here are some examples...**

### **DEVELOPMENT DEADLINES**

With Licensee's help, we define key development items along with projected completion dates and we build those dates into the agreement to ensure continued progress towards getting your invention on the market. You might consider setting some deadlines such as:

- CAD (engineering) drawings completed**
- Initial samples completed**
- Final samples completed**
- Proof of purchase orders**

### **MINIMUM ANNUAL ROYALTY PAYMENTS**

This refers to royalty levels that must be met each year of the agreement; if not met, then you have the right to cancel the agreement.

### **SALES ACTIVITY**

Once the product is fully developed and starts generating royalties, some language to ensure that the Licensee maintains sales throughout the year is desirable. We have some language stating that if Licensee fails to sell "X" units in any continuous six month

period, then Licensor has right to cancel the agreement.

## **9. Hard-core legal language**

We have many paragraphs in our license agreement that have been carefully crafted with the help of many attorneys. These paragraphs include some of the most critical (and the most confusing) issues that you, as a potential Licensor, must address. We strongly urge you to consult with an experienced licensing agent or an attorney to protect yourself and your invention.

### **WARRANTY DISCLAIMER AND LIMITATION OF LIABILITY**

This section should state that Licensor is not making any claims or warranties for things like merchantability, non-infringement, and fitness for any particular purpose.

### **INSURANCE**

This section requires the Licensee to obtain product liability insurance to protect

themselves from any claims or lawsuits (for example, if someone sues them because the product was defective and harmed them). Along with carrying this insurance, the Licensee should also name you, the Licensor, as an additional insured party and provide a certificate of insurance to you for proof of insurance.

## **INDEMNIFICATION**

You want the Licensee to indemnify, or “hold you harmless”...in other words, you don’t want them to sue you for damages that might occur in their use of your invention.

# 10. Housekeeping

Obviously, there are general provisions in every legal agreement, such as defining the “parties” of the agreement, their contact information, the governing jurisdiction (should any conflicts arise, it means WHERE the conflict will be tried or arbitrated), and various other items that serve to answer all the “what if...” questions.

**These questions can include the following-**

**A. What if I die, can the agreement be assigned to my spouse and kids?**

**B. What if the company licensing my invention goes bankrupt?**

**C. What if the company’s factory burns down and they can’t make the product any more?**