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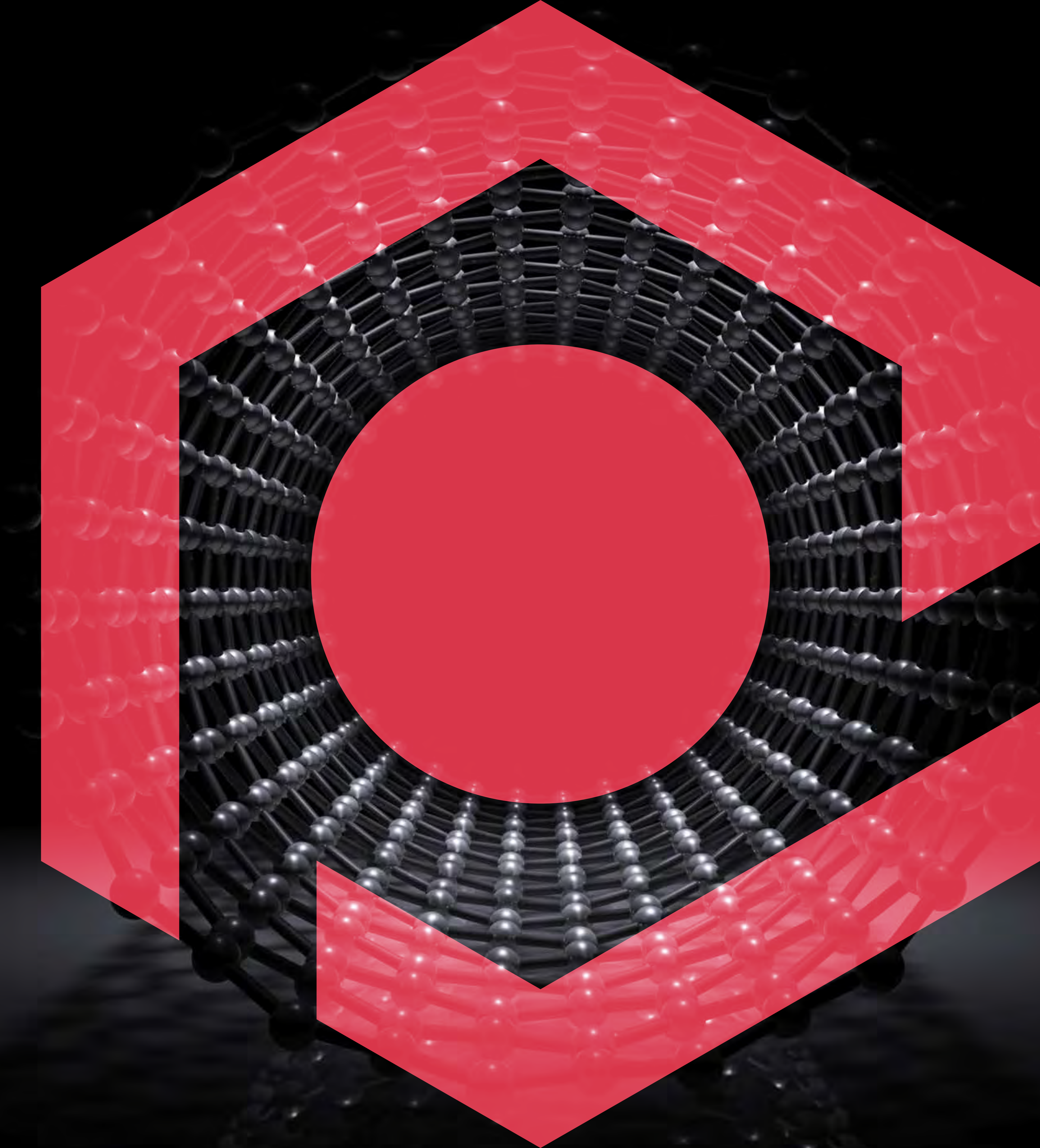
LICENSING INNOVATION WITHIN THE **ADVANCED** MATERIALS SECTOR



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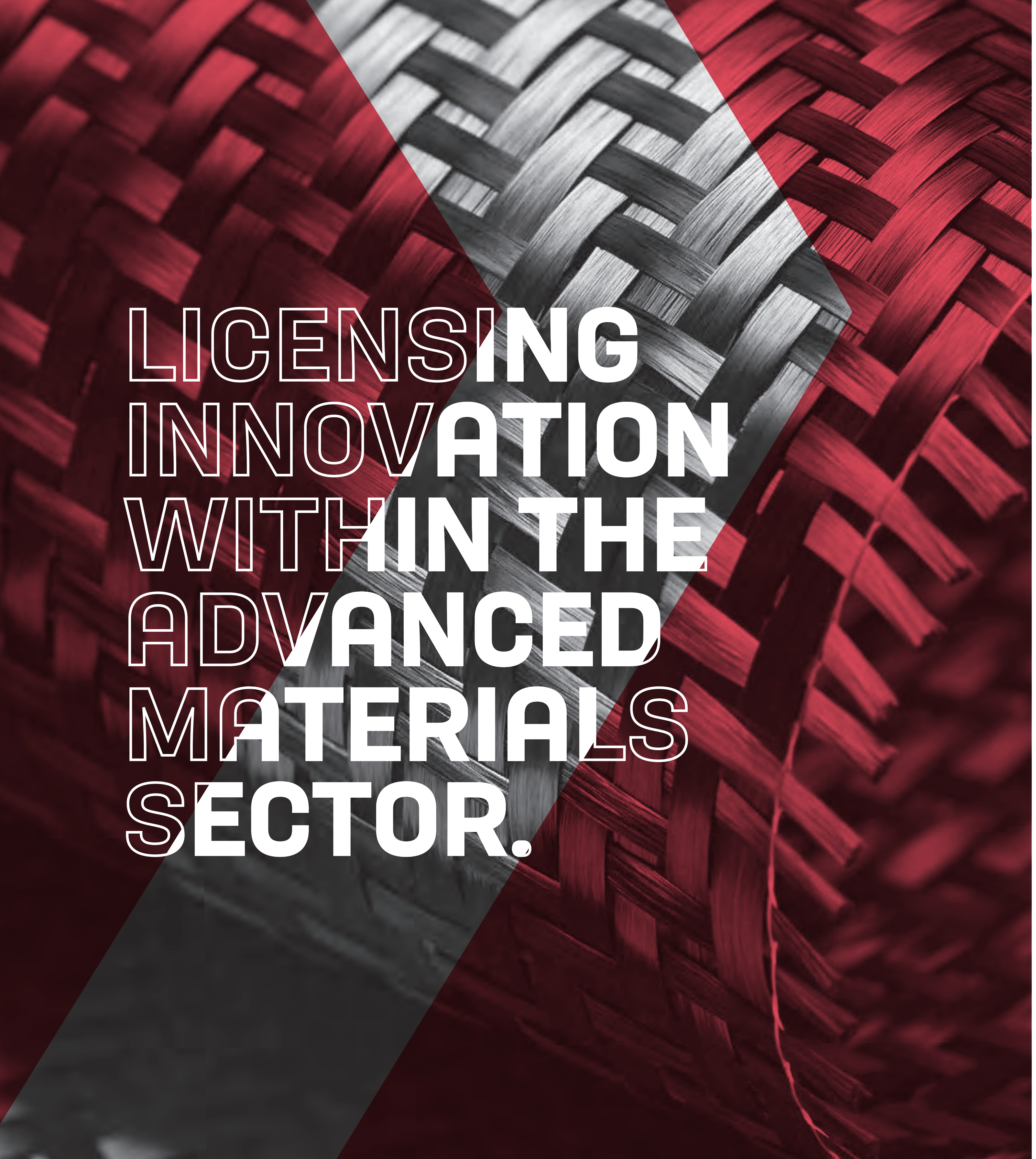


LICENSING INNOVATION WITHIN THE ADVANCED MATERIALS SECTOR.

Advanced materials like graphene, carbon fibre composites, ceramics, nanomaterials and biomaterials are increasingly being employed in almost every type of product, from cars and building materials to clothing and consumer electronics.

If you look around where you are sitting now, almost everything around you - particularly the device you are reading this on - has been made possible by the astonishing advances and innovation in materials science.

However, it is arguable we are hardly scratching the surface of what will be possible in the future.

The most urgent challenges we face today are the energy crisis and the need to improve our healthcare, not only in the wake of the pandemic but also because of our increasing and ageing population. We can say with absolute certainty that these will be tackled by greater innovation in new materials and novel uses of these materials.

And this is a crucial point to note.

The next evolution in advanced materials will not stop at creating new materials. It will hinge on making them easier to use, forcing them to interact with other materials and technologies more effectively, making them less expensive and making it easier to adapt their forms and constituents.

Forcing this level of change is a highly skilled endeavour. It requires expert material scientists who understand how best to leverage combinatorial chemistry and combinatorial biology to experiment and test new ideas. It will involve the perfection of new process technologies in fields like nanotechnology, industrial biotechnology and additive manufacturing.

This expertise could well be needed by some of the OEMs that want to make best use of the materials now available to them but don't have the knowledge required to adapt and adopt the materials they need quickly enough and at scale.

So how can we bring innovators together with manufacturers?

How can we pave the way for the latest materials to find their way into the next generation of consumer products?

We believe the answer lies in the creation and implementation of a robust and specially created licensing model. In this paper we will look at how licensing models benefit both the licensor and the licensee and provide advice on best practice to create the licensing model you need to deliver your commercial objectives.

WHY SHOULD YOU CONSIDER *LICENSING YOUR IP?*

Intellectual property (IP) licences allow certain individuals or businesses to use another's intellectual property rights (IPRs) in exchange for a fee or other valuable consideration.

As opposed to the historic view of IP (creating exclusivity by excluding others from using your innovation), licensing allows other entities to use your innovation while you retain full ownership and full control of the associated IP.

A licence is totally different to an assignment of IP which is an outright transfer of the IP owner's rights, title and interests in certain IPRs.

Licences can be applied to any type of IPR (such as patents, trade marks, copyright, data or right of publicity). Once the licence is in place, the licensor will receive royalties from the licensee. The royalties can be charged as a one-off lump sum, as a fee based on use or items manufactured or sold (or a combination of the two), or as a pre-determined periodic fee.

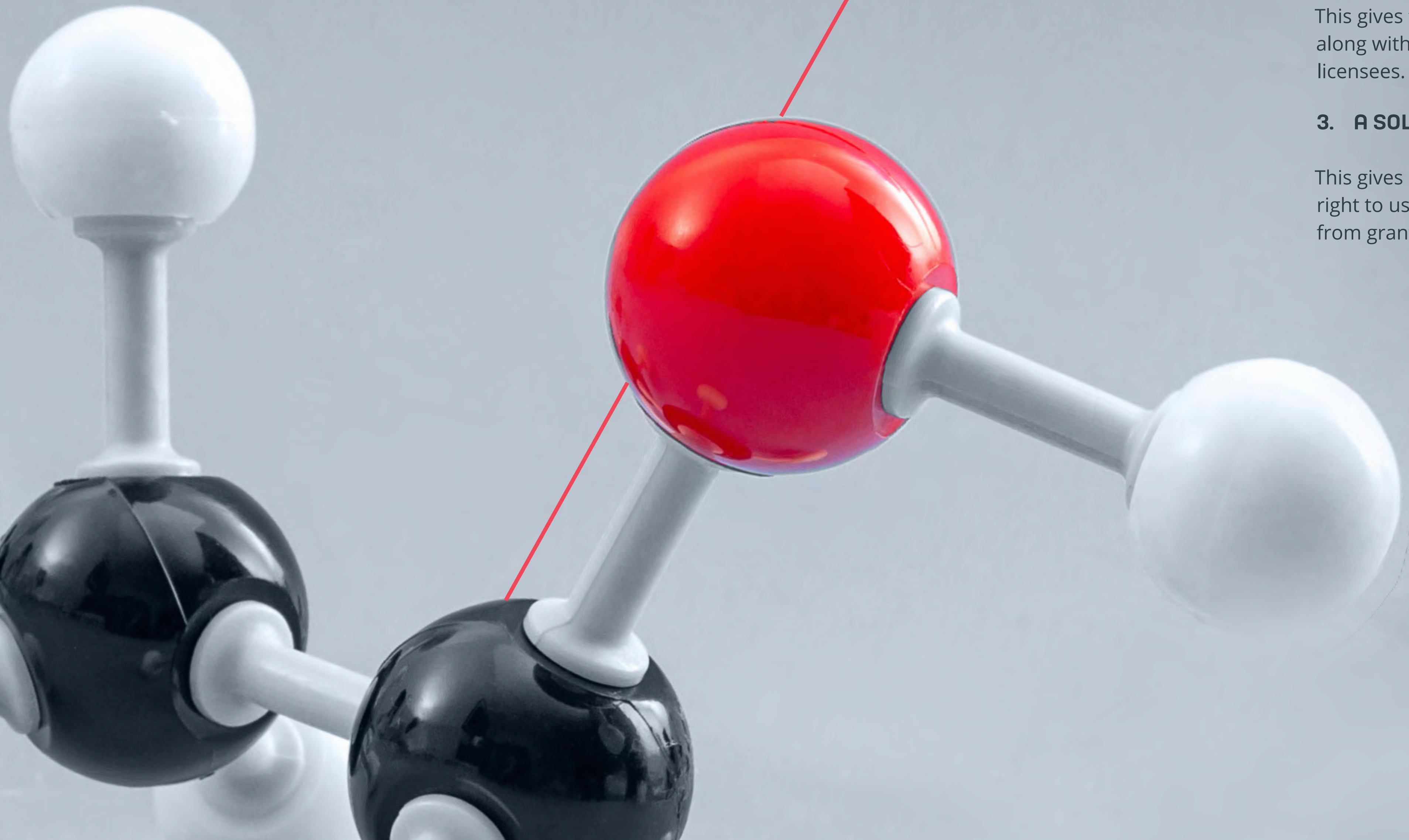
While you're setting the terms of the licence, you may also want to insert additional provisions.

You could ask for the royalty fee to increase over time.

You could link increases to the royalties to sales, revenue or other hard targets (and set consequences should these targets not be met).

You could charge a fee in the event your licensee gives up their licence early or revokes it.

GENERALLY SPEAKING, THERE ARE *THREE TYPES OF LICENCES:*



1. **AN EXCLUSIVE LICENCE**

This would prevent anyone (including the licensor) apart from the licensee from using the IPRs.

2. **A NON-EXCLUSIVE LICENCE**

This gives the licensee the right to use the IP along with the licensor and, potentially, other licensees.

3. **A SOLE LICENCE**

This gives both the licensee and the licensor the right to use the IPRs but precludes the licensor from granting any other licences.

Within the licence you will set out your commercial terms. These are likely to include:

- The subject of the licence (such as a patented process, product or innovation)
- The scope of the licence (such as the countries or territories the licence covers)
- The level and frequency of the royalties
- The duration of the licence (including early termination terms or penalties)
- The terms for renewing or expanding the scope of the licence
- Any limitations (is there a minimum royalty level or will a certain number of products need to be made or sold?)
- Any obligations and/or warranties (for example, who will have the responsibility for enforcing the IPRs)
- Any other considerations (for example, quality control standards, sub-licensing terms or maintaining regulatory compliance)

HOW DOES A LICENSING MODEL BENEFIT THE LICENSOR?

A licensing model is only one option for an innovator, but it is an option that offers a potential licensor several attractive commercial benefits including:

1. RETAINED OWNERSHIP OF YOUR IPRS

This is the most crucial benefit. And not only do you retain full ownership of your IPRs, you also retain the right to say exactly how your IP can be used and how much its use will cost.

2. INCREASED REVENUE

When you license any IPRs, you will earn royalties from the licensee which will immediately open new revenue streams and increase income.

3. REDUCED COSTS

Your licensee will have to bear the cost of production, distribution, marketing and local trading tariffs.

4. INCREASED SPEED TO MARKET

Licensing innovation to manufacturers will take the technology to market much faster than having to establish new production, distribution and promotion channels. This increased speed to market should also help the licensor increase their competitive advantage by being able to move faster than their competitors.

5. REDUCED RISK

Licensing innovation to an established business with an established brand and customer base can be much less risky than trying to create a brand new enterprise from scratch.

6. INCREASED MARKET SHARE

Your inventions will penetrate new markets in new countries which will increase your global reach and your materials' global recognition. It is highly likely this will organically unlock new commercial opportunities.

HOW DOES A LICENSING MODEL BENEFIT THE LICENSEE?

Manufacturers will enjoy a number of key commercial benefits by licensing the materials they need for their products. These include:

1. INCREASED REVENUE

As your product range increases, your revenue will too. Having more advanced materials could also allow the licensee to move into more premium pricing brackets which again will positively impact their revenue.

2. REDUCED COSTS

The licensor will have had to invest their own budget into R&D, testing and obtaining the required regulatory approval, and although some of these costs are reflected in the licence cost, it will still be substantially cheaper for a licensee than innovating itself.

3. INCREASED TECHNICAL EXPERTISE

The licensor will have technical expertise to assist the licensee in making best use of the materials. They may also be able to share a broader perspective on usage, production and marketing that will help improve the licensee's operations and avoid potential pitfalls.

4. INCREASED MARKET SHARE

A larger product range can naturally lead to an increased market share but the ability to produce better products for customers will definitely increase market share. Increased customer confidence due to higher quality products boosts word of mouth referrals and repeat purchases.

5. INCREASED COMPETITIVE ADVANTAGE

Implementing technology where the R&D and testing processes have already been completed by the licensor will allow licensees to produce better products more quickly.

DOES LICENSING HAVE ANY DISADVANTAGES?

Arguably the most important consideration is to identify the right licensee.

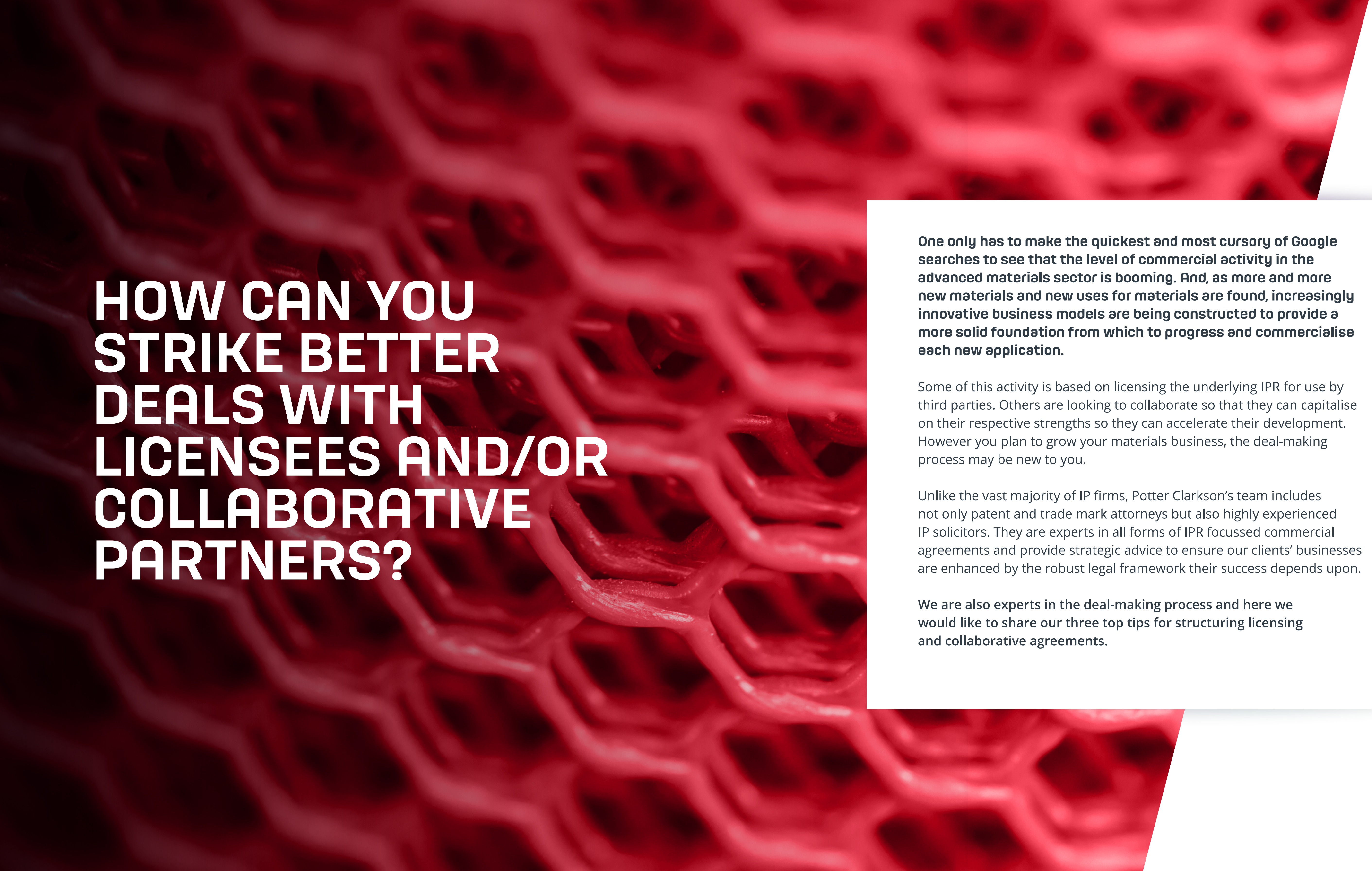
We would always strongly suggest that, before you sign over any rights to your IPRs, you should conduct rigorous due diligence on any potential licensees. This will give you a detailed assessment of their suitability and track record on which to base your decision.

If you don't vet your licensees properly, you may choose less than wisely which can leave you open to:

- Losing full or partial control of your invention.
- Becoming too reliant on your licensee's ability to achieve the financial return you want for exploitation of your IPRs.
- The success or reputation of your invention being hampered by your licensee's poor planning or performance.
- Quality issues

These are best avoided by building as close a working relationship as possible with your licensees. Having a close working relationship will also reduce the risk of you becoming embroiled in a costly and damaging legal dispute should things go wrong.

There is also the possibility of you creating unnecessary competition for yourself by granting non-exclusive licences to licensees in a market you operate in. You can, however, minimise this risk by limiting the scope of any licence you offer.



HOW CAN YOU STRIKE BETTER DEALS WITH LICENSEES AND/OR COLLABORATIVE PARTNERS?

One only has to make the quickest and most cursory of Google searches to see that the level of commercial activity in the advanced materials sector is booming. And, as more and more new materials and new uses for materials are found, increasingly innovative business models are being constructed to provide a more solid foundation from which to progress and commercialise each new application.

Some of this activity is based on licensing the underlying IPR for use by third parties. Others are looking to collaborate so that they can capitalise on their respective strengths so they can accelerate their development. However you plan to grow your materials business, the deal-making process may be new to you.

Unlike the vast majority of IP firms, Potter Clarkson’s team includes not only patent and trade mark attorneys but also highly experienced IP solicitors. They are experts in all forms of IPR focussed commercial agreements and provide strategic advice to ensure our clients’ businesses are enhanced by the robust legal framework their success depends upon.

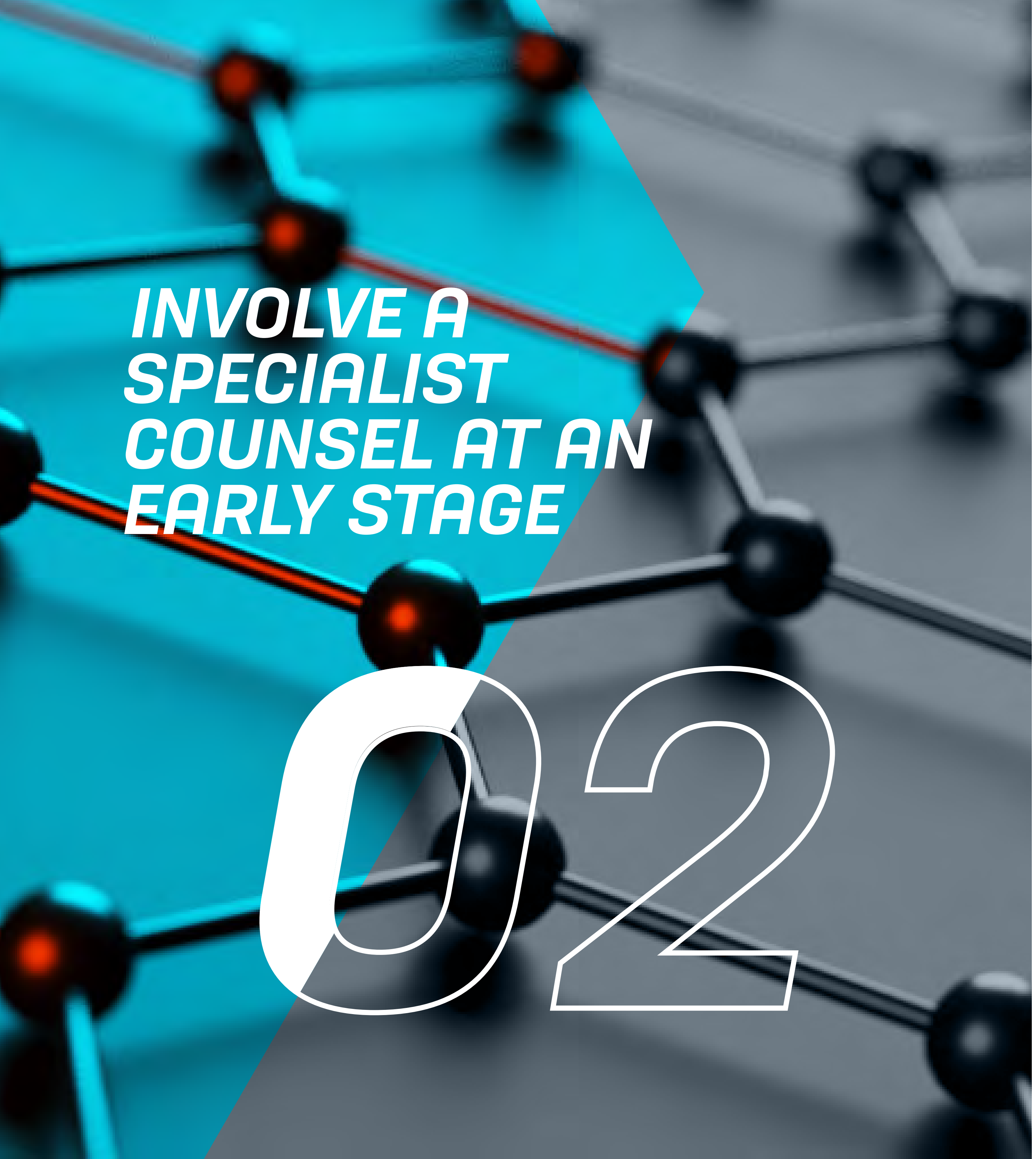
We are also experts in the deal-making process and here we would like to share our three top tips for structuring licensing and collaborative agreements.

PUT A NON-DISCLOSURE AGREEMENT (NDA) IN PLACE FROM THE START

01

As NDAs are so common these days, sometimes people forget to put one in place until after the negotiations have started. We trust it goes without saying this is unwise! Importantly, mutual NDAs should be considered as a positive step in discussions, providing a safe environment for both parties to speak freely around their commercial goals and innovation strategy.

If you don't yet have registered protection for your ideas or know-how, it will be very difficult to argue your ideas or know-how has been infringed after having disclosed the relevant information to your prospective partner or licensee without a well-drafted and specific NDA in place.



INVOLVE A SPECIALIST COUNSEL AT AN EARLY STAGE

02

We appreciate that this recommendation looks like self-interest, but it really isn't.

The initial advice they will provide is highly likely to save you a considerable amount of time and expense in the long run, especially if you can't ultimately strike a deal or if the deal gives rise to potentially damaging complexities later on. Most commonly these complexities stem from issues around competition or anti-trust laws or lack of clarity around the joint ownership of the IPRs involved.

AGREE NON-BINDING HEADS OF TERMS/A NON-BINDING TERM SHEET

03

The parties to a proposed licensing or collaboration agreement will sometimes try to negotiate their licensing or collaboration agreement having only agreed the barest outline for the supporting commercial agreement. This could prove to be a mistake.

A key benefit to having structured heads of terms is that the negotiations around the issues set out in those heads of terms tend to reveal if the parties have different understandings of the basis of the deal. This is best dealt with before you start preparing a complete agreement, particularly as negotiating points of principle whilst drafting can increase the time and cost of progressing this matter or, in a worst-case scenario, your deal could collapse completely at a late stage.

However, if you begin by negotiating and agreeing non-binding heads of terms covering all the fundamental commercial and practical points, you should be able to avoid these issues and ensure the drafting and conclusion of your agreement goes more smoothly.

HOW SHOULD AN ADVANCED MATERIALS BUSINESS APPROACH LICENSING OF IPRS?

The reason why we recommend involving specialist legal counsel at an early stage of a deal in the previous section is because there is always a risk the proposed deal may not work for some reason or, at least, does not work exactly as the parties originally envisaged.

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In addition, specialist legal counsel can ensure that the licence itself achieves your commercial aims (so far as legally possible!). In particular, whether you are licensing out (as licensor) or licensing in (as licensee), the issue of exclusivity and its relationship with royalties is an important one.

Many licensing deals would not be concluded without the grant of some degree of exclusivity to the licensee. Although this is common, the situation the licensor needs to avoid is one in which the licensee underperforms but the licensor cannot bring the exclusivity to an end. Likewise, if you are in-licensing you do not want to be subject to disproportionate constraints or targets.

Typically, an exclusive licence seeks to address the issue of licensee performance in a number of ways:

1. It sets a contractual obligation for the licensee to use its best or reasonable endeavours/efforts to exploit the licensed technology or IPRs as widely as possible and to meet all reasonable customer demand for the licensed product in the licensed field or territory;
2. The licensor provides specific performance metrics which, if the licensee does not satisfy them, could result in the loss of the "exclusive" nature of the licence and can permit the licensor to appoint one or more other licensees in the same field or territory;
3. A short licence term with the need for an exclusive licence to be re-negotiated and reagreed, rather than automatic renewal taking place or a long licence term being agreed;
4. The licensee is required to pay a minimum royalty regardless of the number of actual sales or income in order to keep the licence in place.

None of these are necessarily a complete panacea for the following reasons:

1

ENDEAVOURS/EFFORTS OBLIGATIONS

Under English law, a "best" endeavours/efforts obligation, while not being an absolute obligation, is an onerous one for a licensee because it could require the licensee to apply all its resources to the achievement of the object of the obligation (for example, meeting all reasonable customer demand for the licensed product) without having regard to the competing needs of its business.

The inclusion of such an obligation could, therefore, be of real assistance to a licensor in dealing with an underperforming licensee, but clearly could be considered disproportionate by a licensee. However, because a "best" endeavours obligation is such an onerous one, it is rarely given in this context, at least by a properly advised licensee, and is generally amended to "reasonable" or "all reasonable".

The less stringent obligation should still assist the licensor in dealing with a licensee who is doing nothing, or next to nothing, to try to exploit the licensed technology or property by allowing it to terminate the licence for breach in clear circumstances of failure to perform.

In any other circumstances, however, it may be difficult for the licensor to prove a breach since, in determining whether the licensee is using its reasonable endeavours/efforts, any other calls on the licensee's resources must be taken into account.

2

TARGETS AND KEY PERFORMANCE INDICATORS ("KPIS")

Where the licensor is familiar with the business of the licensee, the prior agreement of specific targets or KPIs in a schedule to the licence which is reviewed on a fairly regular basis (for example annually or every three years) can be a pragmatic way for the licensor and licensee to agree a minimum expected level of performance. This may include marketing spend levels, dates for milestones on which the licensee will launch specific products or in specific territories, or the number of "new" customers achieved in a specific territory.

It is not uncommon for an exclusive licensee to lose its exclusivity rights if it fails to meet KPIs or minimum performance standards for two consecutive assessment periods, which can provide a helpful basis for a licensor to supplement its income in a particular field or territory if the existing licensee is underperforming.

However, these indicators can be relatively difficult to agree, particularly where the licensor is not familiar with the market, or the product is entirely new to the market (e.g. a novel product rather than a development or improvement to an existing product).

In these circumstances, a more straightforward solution may be preferred by both parties. In addition, the licensor should consider the administrative burden of auditing, and conversely, the licensee should consider the administrative burden of reporting and being subjected to audit on these factors.

3 LICENCE TERM

A licensor is never obliged to provide a long-term licence to a licensee.

There are a number of benefits to agreeing a long licence term, including certainty of commercial arrangements, perhaps guaranteed income (where a minimum royalty is used). However, where the performance of a licensee is not established, or sensible targets could not be agreed, resorting to a shorter-term licence may provide the parties with the ability to exit the arrangement if it is not mutually beneficial, or even beneficial to one party.

This can be achieved by a number of methods, including a fixed term licence where expiry is automatic, and a new licence must be agreed and executed in order to continue the relationship or an elective break clause (e.g. two years into a four year licence).

Again, all of these provisions need to be agreed in advance, and a licensee may wish to negotiate a lower royalty percentage on the licence where it has less certainty as to the ongoing use of the technology in question. This is not unreasonable on the basis that the licensee may be expending substantial set-up costs for a licence which may only run for two years.

4 APPROACH TO EXCLUSIVITY AND ROYALTIES

As we have explained above, there are numerous factors that can be used to try and ensure a fair and controlled relationship between licensor and exclusive licensee which avoid the parties being tied into an exclusive relationship that is not beneficial for the party concerned.

Most commonly, balancing these controls both commercially and legally will take time and forethought, and these are best agreed in heads of terms. Engaging experienced legal counsel at the early stages of negotiation will mean that we can provide you with guidance on a sensible balance of obligations as between licensee and licensor, and the implications of the proposed structures.

Your legal advisors should be commercially astute, and where possible, understand the technology and your market segments well to ensure that you receive the best results in your agreements.

5

MINIMUM LOYALTIES

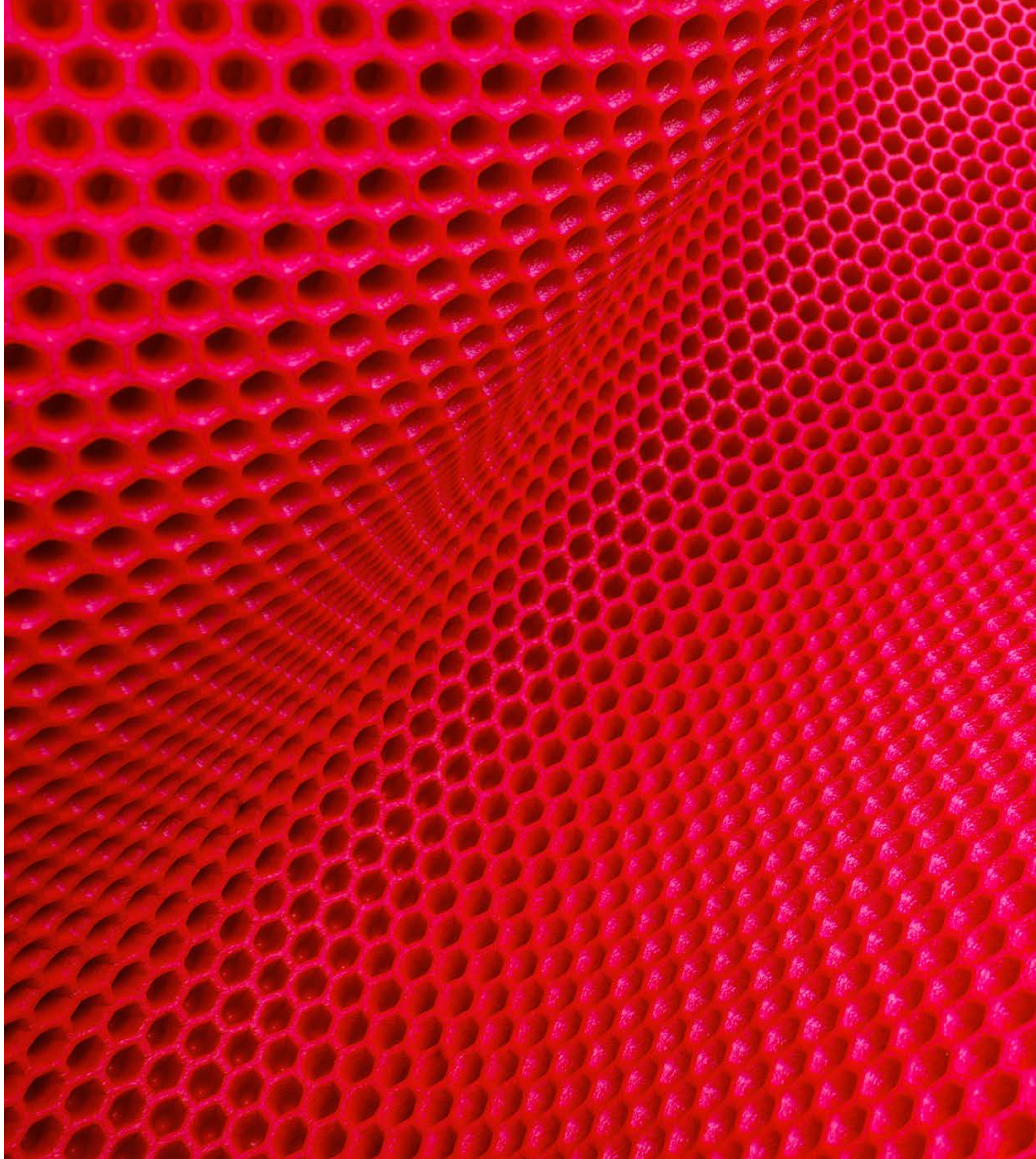
A mutually agreed minimum royalty obligation is usually a good way for a licensor to ensure a minimum level of commercial benefit from the arrangement. However, whether it achieves precisely what the licensor is looking for will depend upon a number of factors including, of course, the level of minimum royalty that is agreed.

In many situations, there will be a large amount of guesswork in predicting the sales and profits that a diligent licensee will achieve. Sometimes it turns out that the licensee can achieve the minimum royalty while still leaving a large part of the potential market untapped.

Careful consideration also needs to be given to the consequences of the licensee not achieving sales sufficient to generate the minimum royalty. For example, should the licensee be able to avoid termination in these circumstances by making up the shortfall between the earned royalties and the minimum or should the licensor be able to terminate the agreement in any event? As mentioned above, it may be more appropriate for the licensee to simply lose its exclusivity in that field or territory as a result of failure to achieve the minimum royalties for two consecutive assessment periods (for example).

If the minimum royalty was set at the bottom end of the parties' expectations, a licensor will probably not wish to settle for the payment of that sum for, say, the 20 year life of a patent. Looking at this situation from the other perspective, it is rare, in our experience, for the licensee to be given any termination rights when earned royalties are below the minimum royalty level.

Yet, if this is the situation and it continues for more than a year or two despite the licensee's best efforts to market and sell the licensed products, then the licensee may be as, if not more, concerned than the licensor about the agreement continuing for many further years as it is likely that the arrangement is not commercially beneficial for the licensee either! The licensee should, therefore, at least consider seeking to negotiate a reciprocal termination right to cover this situation.



SPEAK TO OUR EXPERTS

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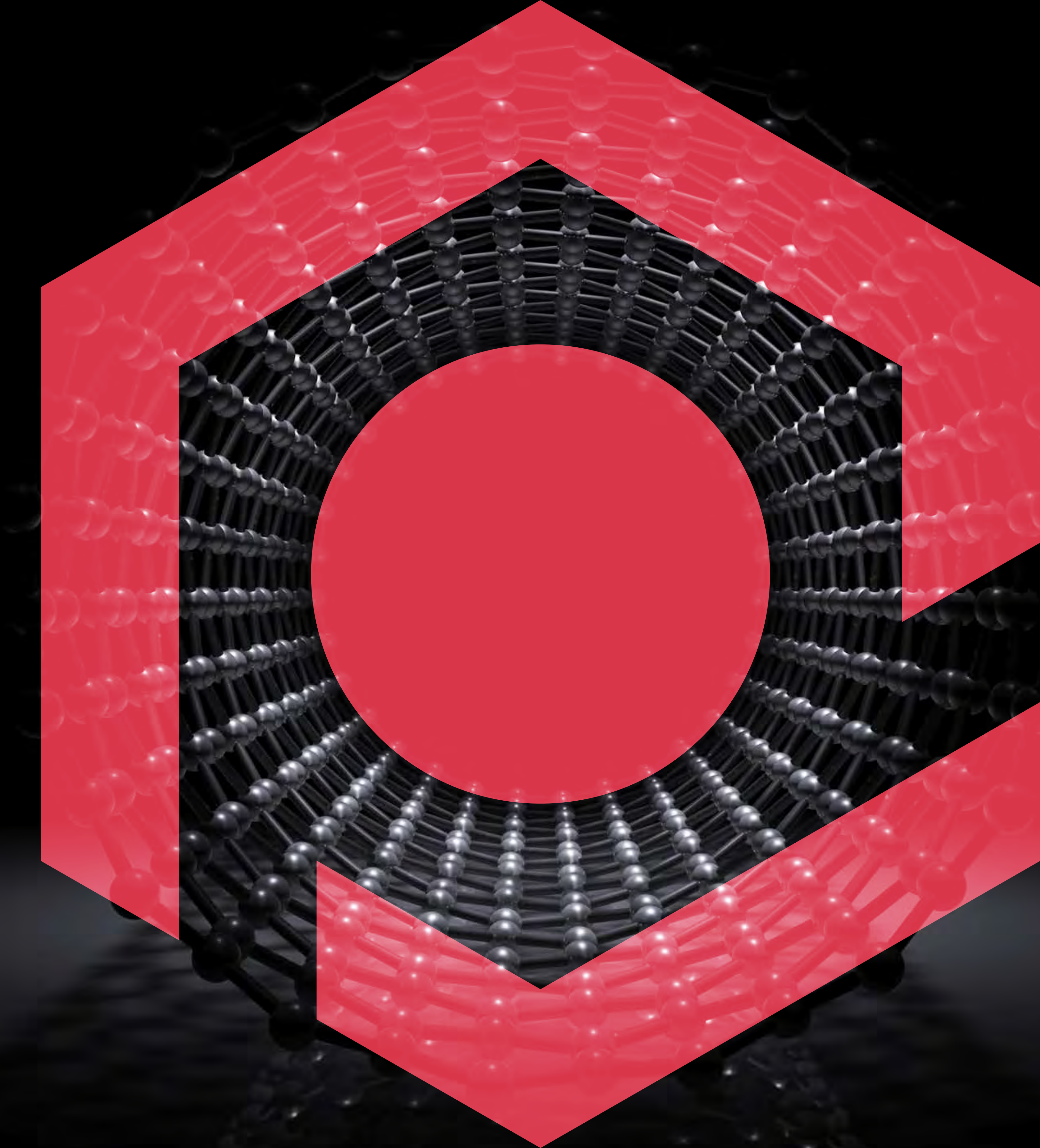
An excellent firm to deal with. They have invested in gaining a thorough understanding of our approach to projects, their communication is timely and concise, and their advice is easy to understand."

Chambers & Partners, 2022

A key strength of Potter Clarkson is their combination of expert attorneys with solicitors, which gives comprehensive advice on highly technical matters using patent attorney expertise and solicitor know-how, as well as commercial and branding matters with trade mark attorneys and solicitors working together."

Legal 500, 2022



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