

Licensing Agreement

Questions*

(1) What does each party receive under the licensing agreement? What constraints are placed on the ability of the Licensee to export from Brazil? See the two “whereas” clauses in the **Preamble** and paragraphs (1) and (2) under the **Grants** section. May the Licensee sell the Recombining Systems outside the Territory covered by the agreement? May the Licensee export Recombining Systems to the United States? Conversely, may the Licensor export Recombining Systems from the United States to Brazil?

(2) Evaluate the provision on royalties of the draft license agreement. Note that Article III Royalties of the agreement provides that the royalty is to be based on 10% of different formulations (selling price and profit). Is this a satisfactory arrangement from the perspective of the Licensor, the Licensee, the government of Brazil?

One way to avoid even these potential problems with royalties is to pay the royalty in one lump sum at the beginning of a license agreement. What advantages and disadvantages do you see in this arrangement?

The most common manner of paying for licensed technology under a license agreement is on a so-called running royalty basis. Running royalties may be computed on a percentage or a straight money basis, *e.g.*, 1 cent per pound, 5 cents per square yard, or 25 cents per barrel. What advantages, if any, do you see in using a percentage royalty arrangement as compared with a straight money basis?

Another method calculating a running royalty is a percentage of the net sales or selling price of licensed products. What party does “selling price” favor? Why? If this method is used, it is important to define exactly what is included in the “net sales price.” Taxes, credits for returned products, quality discounts, freight allowances, cash discounts, and agents’ commissions are normally omitted from the net sales price. A definition of “net selling price” might read: “gross amount invoiced by Licensee on sales of licensed product, less returns, rebates, trade discounts, cash discounts, sales taxes, and transportation charges allowed to purchaser.”

A final method is to use a percentage of net profit. What does party using “net profit” favor? Why?”

Consider the provisions in paragraph (5) of Article III of the agreement. Is it satisfactory from the perspective of the Licensor? If not, what changes would you advise?

(3) Another major difficulty with royalty payments is the rapid rate of fluctuation in

*Adapted from Swan & Murphy and Mendoza.

currency values. For example, if the Licensee receives 1,000,000 Brazilian reals from a purchaser of a Recombining System when 10 reals equals \$1, and then remits a royalty payment pursuant to the license agreement when the rate is 15 to 1, the Licensor has suffered a 33 1/3% decline in the value of its royalty payment. A common way of protecting the Licensor or Licensee against currency fluctuations is to provide for an adjustment of the royalty to correspond to the devaluation or revaluation.

Although it is not present in the draft agreement, it is often advisable to insert a clause in the licensing agreement that provides for periodic renegotiation of the provisions on royalties — particularly if a long term arrangement is contemplated. Such a clause may also be looked upon with favor by the government of the Licensee's country.

(4) Consider paragraph (1) of Article VII and paragraphs (1) and (2) of Article IX of the license agreement. Under these provisions how long is the licensing agreement likely to last? Will these provisions be acceptable to the government of Brazil? To the United States Government? Does the TRIPs Agreement have any relevance? If these provisions raise problems, how might they be revised?

(5) Would paragraph (5) of Article XI of the agreement raise any objections from the government of Brazil? Does TRIPs have any relevance? From United States authorities? As counsel for the Licensor, how would you respond to such objections?

(6) Consider the provisions on choice of law and arbitration in paragraphs (2) and (3) of Article XI. Are they satisfactory from the perspective of the Licensor? Suppose the government of Brazil does not recognize the validity of such provisions. Should the Licensor refuse to go ahead with the licensing agreement?

An alternative arbitration provision is:

Any conflicts arising under this Agreement will be decided by arbitration in accordance with the Rules of the American Arbitration Association, each party to appoint an arbitrator, and the two thus designated to select a third. If either party fails to appoint within sixty (60) days or the two fail to pick a third, the American Arbitration Association will have power to make the appointments as contemplated herein. The arbitration will be held as promptly as possible at such time and place as the arbitrators may determine. The decision of the majority of the arbitrators will be final and binding upon the parties, and the expense of the arbitration will be shared equally. Judgment upon the award may be entered into by any court having jurisdiction.

Does this provision cover all the issues of concern?

(7) United States export controls must be taken into account in most licensing arrangements. Especially if the product licensed qualifies as high technology, one must be

concerned about the possible imposition of so-called national security controls. Does this product seem likely to be of concern? Under such controls it would be the responsibility of the Licensor to ensure that the Licensee did not export the licensed product to a prohibited designation.

(8) Is it not uncommon to have provisions like those in Art. VIII. Paragraph A deals with infringements of the patents the Licensee receives under the Agreement. Paragraph B refers to infringement suits brought against the Licensee who is using the licensed patents. The Licensee usually demands that the Licensor take on infringement suits brought against it, thus the warranty provision in Paragraph B. Since the Licensee is paying for the right to use the Licensor's technology, it should be able to manufacture the licensed product free of interference by a third party.

(9) Art. XI(F) is an example of a "most favored Licensee" clause? What purpose does this serve? What party does it favor? Does it work to the advantage of both?

(10) There are a number of provisions not included in the draft license agreement but worthy of serious consideration for inclusion. For example, a license agreement should probably contain a *force majeure* clause and a provision requiring the Licensee to obtain government approval of the licensing agreement.

In a country like Brazil, the license agreement would almost surely have to be approved by a government agency or at least registered with a government agency. The license agreement would normally require the Licensee to obtain the necessary approvals, since it will be more knowledgeable than the Licensor about local procedures and government personnel.

There is also the possibility of needing an option agreement. Often the potential Licensor and Licensee enter into an option agreement *before* entering into the license agreement itself. Under this arrangement, the license agreement goes into effect only if the Licensee decided to exercise the option. This arrangement allows the Licensee a period of time (say 90 days to 6 months) in which to evaluate the licensed technology.

If there is to be technical assistance provided to the Licensee this also needs to be included. Assistance in the design, construction, and operation of a complex facility may be indispensable to the success of Licensee's operations. The agreement should state clearly whether the Licensee or Licensor is responsible for the salaries and expenses of technical personnel furnished by the Licensor to the Licensee. A common arrangement is for the Licensor to bear such expenses for an initial period of time; thereafter, the Licensor provides technical personnel only if the Licensee agrees to pay their salaries and expenses. Conversely, a license arrangement may provide that the Licensee may send technical personnel and members of its own staff to the Licensor's plant for on-the-site training.