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“Intellectual Property lies at the centre of the modern company's economic success or failure”

Lester Thurow : Economist

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An Introduction To Licensing

by Liz Ward
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Licensing is often poorly understood, especially in some of the new and emerging economies of the world. It does however offer businesses a very real opportunity to maximise income streams on technology and to exploit technology in new markets.

Making money from Technology

Licensing is basically the grant of a right to do something, usually in return for a payment – also known as a royalty. Licensing is like someone owning a house and letting different parts of the house to different tenants. As with a multiple occupancy building, different tenants can be granted a variety of rights to occupy exploit and use some parts of the property. However, a licence does not grant the tenants any rights in the physical bricks and mortar of the property. The licensee has the right to use the patent, know-how, trade mark, design right or copyright etc, but the licensee does not own the legal title to it, nor (unless specifically permitted by the licence) are they often granted rights to grant sub-licences of the intellectual property.

Most people are vaguely aware of licensing through the software industry. At some point most people will have “clicked” to accept a Microsoft software licence or something similar. In fact, the wealthiest companies today are ones such as Microsoft and IBM which depends on “clicks not bricks” as assets. Licensing is therefore much more widespread than would first appear.

Licences are widely used in the automotive industry. Licensing allows a car manufacturer to invest a great deal of resources in developing new technology such as new brakes or gearing and then to licence this technology to other car manufacturers in return for a royalty. This type of cross-licensing is widespread and by collaborating in this way many manufacturers can recoup the costs of research and development much sooner than they would by simply using the technology purely to their own advantage in their own products.

Royalty Streams and Valuations of Intellectual Property

One of the most common questions asked is what is a particular piece of technology worth in terms of outright sale value or indeed when licensed what could one expect as a royalty stream. A number of factors affect this and it is essential to take expert advice. It is extremely difficult to value intellectual property and it is a very different process from valuing bricks and mortar. With tangible assets such as commercial buildings there will be an acceptable norm in any particular locality for a type of building. Unfortunately, technology is often unique in the market place and it can therefore be a complex and time consuming process to fix any sort of value to it. To a certain extent the same happens with royalty streams although different industries do have accepted norms as royalty values. A number of accountants and solicitors specialise in this area and it is important to get the right advice early on so that negotiations can proceed on a proper commercial basis.

Factors affecting the value of technology will include the cost of creating the technology, the uniqueness of the technology, barriers for other people entering the market, whether or not the technology can be licensed and so on. When considering licensing it is vital to consider the income streams that are likely to be generated once the product is licensed. Obviously, products with mass market appeal can generate huge income streams even if the royalty payable on each individual item is very small. On the other hand, technology which is in a niche arena may attract a much higher individual percentage royalty payment simply because it is not capable of mass exploitation.

Key Advantages of Licensing over other structures

Many companies look at joint ventures or partnerships and collaborations especially when considering developing overseas markets. The big problem with joint ventures and similar vehicles is that the parties become jointly responsible for a number of issues such as finances and management of the company when in practical terms it is likely to be more commercial for one party to have responsibility for certain decisions alone. Joint ventures can work well but they are inherently flawed in terms of joint management decisions and this is often where disputes arise. On the other hand,



licensing permits the exploitation of new technology without the burden of managerial decisions for both parties. Having said that, however, it is important for both licensor and licensee to understand commercially where the markets lie and to agree a joint marketing strategy of some kind in order to achieve maximum sales. Unfortunately joint ventures often fail as they require a like-minded business culture which can be difficult to achieve, especially in an overseas market where business practices, attitudes and cultural values can vary widely.

Joint ventures can also be extremely expensive to set up as the legal costs involved may be significant. There are countries however, where it is impossible to trade unless one has a local party who is domiciled in that country. An arms length licence may avoid such problems.