Landing a Big Licensing Deal

What to include in your license agreement
Introduction

Landing a big licensing deal is by far the most popular goal of most inventors. The idea of having a company develop, manufacture and market their invention and then paying them an ongoing royalty on sales of the product is very enticing to many inventors.

Finding the right company to license an invention is only one step in the process. Once a company expresses interest in an idea they will perform a detailed evaluation on the invention, called “due diligence”. This evaluation helps the company determine if an invention is something they would like to license from the inventor. Once the company has decided to license an invention the next step is to negotiate the terms of a license and executing the license agreement.

If you’re not familiar with the term license agreement, it is when an inventor, known as the licensor, agrees to let a third party company, known as the licensee, commercially use their invention for a period of time. As a result of the agreement, the inventor would receive either an ongoing payment called a royalty or a one time, lump sum payment.

What are the key components to include in a License Agreement?

Navigating license agreement negotiations can get complicated so InventionHome handles that process for our clients. Since 2003 InventionHome has completed
hundreds of license agreements for our inventor clients and we have accumulated tremendous experience in the process. We have developed and fine-tuned a license agreement template that works in favor of our inventor clients and contains all the necessary components to maximize your success.

Whether or not you choose to use InventionHome’s services, it is important to be informed about the main components of a license agreement because a license agreement can be confusing when you read it over. Much of the content will consist of potentially complex legal definitions, timelines and specifics of deliverables. We are providing this document to you so that you can be prepared and make good decisions should you find yourself in the fortunate position of finding a company that wants to license your invention.

As you work through your own license agreement, here are 10 key components of an agreement that you should understand.

1. Definitions

License agreements typically define essential terms that are used throughout the document to ensure that there is no ambiguity. As an extreme example, 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 as being a “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 pay you money in the form of royalties.

INTELLECTUAL PROPERTY RIGHTS - This term may refer to 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 is the money?”

Since a majority of our agreements have based the inventor’s compensation on royalty payments (not an outright purchase of an inventor’s assets, patent(s), etc.), let’s reflect on what that means for how you would ultimately get paid. A royalty is the amount of money paid by a licensee to a licensor for the use of the licensor’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 commonly 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 status, development stage of the invention, profit margin for the licensee, and the like.
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, and rebates.

C. Sometimes royalty 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 an up-front payment instead of future royalty payments or a partial advance up-front, which would then be deducted from future earned royalties. While an advance payment is a highly desirable feature for a license agreement, in most cases the licensee will not be willing to offer an advance in light of the large investment and risk that they are taking on by licensing a product. Some of the expenses that the licensee may face post-license are funding design engineering and prototype development, covering the cost of tooling, sample production and packaging design, and paying for inventory production, warehousing, and marketing/ selling expenses. Advance payments do occur, but not always and maybe not at the dollar amount that you would ideally like. 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 a quarterly schedule and stipulates that 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 licensor (or their broker or agent) is permitted to audit the accounting records of licensee.

5. Territory

Territory is another component specifically defined in an agreement. Are you giving the licensee worldwide, exclusive rights to your product? If they sell their products only in North America, then the territory that you grant might give only North America rights so that you could pursue a different agreement for a company with distribution in other countries.

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 several 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 the licensor and the licensee fulfill their obligations stated in the agreement. Termination language should be included to give definition to both parties’ rights when the agreement is cancelled or expired.
7. **Improvements**

To illustrate this component, let’s imagine that you license your invention, and then the licensee transforms your product from something very “vanilla” into a tricked out, upgraded 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 feel that’s the way it should be since the core of the idea was yours in the first place.

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 licensees honest and accountable to a defined schedule.

Here are some examples:

**DEVELOPMENT DEADLINES**

With the licensee’s help, we define key development targets 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 they are 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 use some language stating that if the licensee fails to sell “X” units in any continuous six month period, then the licensor has the 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 multiple attorneys. These paragraphs include some of the most critical issues that you, as a potential licensor, must address. Because these issues can also be the most confusing, we strongly urge you to consult with an
experienced licensing agent, broker, or an attorney to protect yourself and your invention.

WARRANTY DISCLAIMER AND LIMITATION OF LIABILITY

This section should state that the 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 the company 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 as proof of insurance.

INDEMNIFICATION

You want the licensee to indemnify, or “hold you harmless”. In other words, you don’t want them to be able 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 (referring to where any conflicts, should they occur, 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. If I die, can the agreement be assigned to my spouse, children, or other next of kin?
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?

We hope you have found this guide helpful.

Good luck in your negotiations and if you need help, please contact InventionHome at 1-866-844-6512
Licensing Support

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