

Anatomy of a License Agreement

How to Efficiently and Meticulously Analyze Agreements

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In light of the January 4, 2011 ruling on the Uniloc USA V. Microsoft patent infringement case, analysts around the world are certain to see a heightened need for using fact-based evidence as an alternative to the now unsupported 25 percent rule of thumb.

In response, analysts will likely turn to third-party intangibles license agreements for comparable transactions and terms. While license agreements can provide an excellent source of fact-based evidence, locating key licensing terms within these documents can be quite complex. No two agreements are identically constructed, and proper analysis to find evidence of comparability can often take intense research from even the most seasoned analyst.

Intangibles license agreements vary in size, structure, and intricacy, yet most un-redacted documents will contain these key licensing terms within the document:

- **Agreement parties** (licensor, licensee);
- **Relevant dates** (effective date, duration of agreement);
- **Description of intangibles being licensed** (including associated products with which they are related and industries in which they are used);
- **Considerations** (royalty rates, lump sums, milestone payments, etc.); and
- **Coverage** (territory and exclusivity).

The challenge is that there is no one standard for where these elements fall within an agreement or for how those sections are labeled. In fact, when more than 10,000 intangibles license agreements were analyzed¹, it was rare to find two that were nearly identical in construct. While no clear construction pattern emerged among the 10,000 analyzed agreements, the most common flow tended to be some variation of:

1. **Introduction** – agreement parties, locations of parties, specific company names and effective date;
2. **Recitals** –containing background information regarding what the agreement parties are trying to accomplish, whether there are any previous agreements between the parties or effecting the current agreement, industry particulars, and what type of intangibles are being licensed;
3. **Definitions** – context behind specific terminology in agreement;
4. **License or Grant (s) of Right** – detailing what is being licensed, and how/when/where it can be used;
5. **Payments** – royalty rates and other types of considerations;
6. **Legal Terms** – defining on-going activities such as how royalty payments will be audited;
7. **Intellectual Property** – IP ownership protocols such as maintenance and enforcement;
8. **Confidentiality** – explaining what can and cannot be disclosed and to/by whom;
9. **Term/Duration** – length of agreement and any termination rights/procedures;

10. **Warranties** – declaring lawful ability of each party to enter into the agreement;
 11. **Indemnification** – liability limitations and dispute resolution protocol;
 12. **Miscellaneous** – containing terms and information such as governing law, how modifications can be made, and the relationship of the parties;
 13. **Signature** – noting authorized officer for each party and date signed; and
 14. **Exhibits and Attachments** – additional information previously referenced in an agreement.
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EXPEDITING INTANGIBLES LICENSE AGREEMENT ANALYSIS

With over 14 sections of terms and general contract language to communicate, it is not uncommon for agreements to exceed well over 100 pages. As a result, many analysts streamline their research by pairing agreement summaries (offered by data providers) with full license agreements in their review process. Agreement summaries distill important details that empower an analyst to quickly reject the transaction based on some non-comparable factor relative to the transaction under study. When the potential pool of comparables is narrowed to align with the functional and risk profile of the tested transaction, analysts can conduct the necessary due diligence by reviewing the full license agreement text.

The full license agreement text contains the entire context of terms and factors that may affect comparability to the tested transaction and also providing vital evidence in litigation matters. Using a process to review both agreement summaries and full text documents can significantly streamline a search process while ensuring appropriate due diligence has been performed.

ATTENTIVE ANALYSIS OF AN INTANGIBLES LICENSE AGREEMENT SUMMARY

Exhibit 1, provided by ktMINE Royalty Rate Finder, offers an example of a summarized license agreement showing key licensing terms that can affect the comparability of one transaction to another.

Exhibit 1

Agreement 1 of 1				
Synopsis				
Grant the right to enter into a SETTLEMENT AND LICENSE AGREEMENT whereas CYTOMEDIX, INC. filed an action on November 10, 2004, Case No. RWT-04-CV-3593, in the United States District Court for the District of Maryland, relating to a controversy between the parties arising in connection with claims of infringement of U.S. Patent No. 5,165,935 entitled "Wound Healing Agents," based upon MEDTRONIC, INC.'s manufacture, use, offer to sell, and/or sale of certain products, and the parties desire to settle the claims that have been filed or asserted in their respective pleadings in the Maryland Action and to enter into a mutually agreeable licensing arrangement.				
Grant the right to utilize the Licensed Patents entitled "Wound Healing Agents," to make, have made, use, import, sell, promote, market, offer for sale or otherwise transfer Royalty-Bearing Products (Hardware Product(s) consisting of Medtronic branded equipment or equipment purchased from Medtronic for resale under a trademark, tradename or brand name of Medtronic having instructions for use primarily for producing compositions consisting of platelets or platelet releasate, including but not limited to platelet concentrate, to facilitate the healing of wounds or other damaged tissue, and Disposable Product(s) consisting of Medtronic branded disposable equipment or disposable equipment purchased from Medtronic for resale under a trademark, tradename or brand name of Medtronic having instructions for use primarily intended for producing, in conjunction with Hardware Products, or applying compositions consisting of platelets or platelet releasate, including but not limited to platelet concentrate or platelet rich plasma, to facilitate the healing of wounds or other damaged tissue) in the Licensed Fields (any and all fields of use) throughout the world.				
Agreement ID:	1105			
Filing Company:	CYTOMEDIX INC			
Licensor(s):	CYTOMEDIX, INC.			
Licensee(s):	MEDTRONIC, INC.			
Effective Date:	05/1/2005			
Term:	If this Agreement is not terminated sooner as provided for herein, it shall terminate with the expiration of the last to expire of the Licensed Patents.			
Type:	MANUFACTURING/PROCESS INTANGIBLE, OTHER			
Industry:	BIOTECHNOLOGY, HEALTHCARE: PRODUCTS AND SUPPLIES			
SIC Code:	3841			
Territory:	WORLD			
Exclusivity:	NON-EXCLUSIVE			
Patents:	-			
Royalty Rates				
License Actuals	Value	Agreement Base	Modifier	Common Base
	1.5%	NET SALES PRICE	Licensee shall pay an Earned Royalty on sales of Royalty-Bearing Products that take place after the Effective Date and prior to November 24, 2009 under the following conditions: The Earned Royalty rate shall be one and one-half percent (1.5%) of the Net Sales Price of Hardware Products sold in countries where the sale of such Hardware Product is covered by a granted, valid, unexpired patent within the Licensed Patents.	NET SALES
	7.5%	NET SALES PRICE	Licensee shall pay an Earned Royalty on sales of Royalty-Bearing Products that take place after the Effective Date and prior to November 24, 2009 under the following conditions: The Earned Royalty rate shall be seven and one-half percent (7.5%) of the Net Sales Price of Disposable Products sold in countries where the sale of such Disposable Products is covered by a granted, valid, unexpired patent within the Licensed Patents.	NET SALES

Description of Licensed Intangibles and Rights Granted^[1]

The Synopsis details the rights being granted for what type of intangible(s), and Agreement Type lists all applicable category(s) from which intangibles are being licensed. This detail can be used to initially assess whether the intangibles within this agreement are comparable to the tested transaction.

Parties to Agreement

Documents the Filing Company, Licensor(s) and Licensee(s). This information can provide a snapshot into the possible relationship between the parties.

Relevant Dates

The Effective Date is useful for validating that a transaction is contemporaneous with market conditions of the subject situation. The Term summary helps determine if the agreement is still in effect.

Relevant Industry(s)

The Industry(s) field documents all applicable industries directly related to the intangibles being licensed therein and the industry(s) in which the licensee has the right to exploit the intangibles. The SIC code noted documents what SIC code was recorded by the Filing company, if one was provided. The Industry information can often provide a reliable benchmark from which to initially validate the comparability of an agreement, as the SIC code may not correlate with the actual intangibles or industries exploited in the agreement.

Geographic Impact

The Territory and Exclusivity summary offers details to assess the potential geographical market influenced by the agreement.

Consideration

The Royalty Rate section provides a comprehensive breakdown of all royalty rates within the license agreement, including tiered payment structures. This information is useful for ensuring the consideration bases are comparable to the tested transaction. Complete royalty rate data is a critical factor for identifying all variables that might be considered to calculate an appropriate range of results.

FULL TEXT ANALYSIS OF AN INTANGIBLES LICENSE AGREEMENT

While intangibles license agreement summaries can significantly streamline the analysis of potential comparables, it is imperative to read the full text for additional terms or details that can impact results.

Validation of Intangibles

The full text of a license agreement can provide additional details justifying, or negating, the comparability of particular intangible. If negating, this detail can be used to either make adjustments to an analysis or to document the reason why a comparable was rejected. Within the actual agreement, this information would typically be found across several different sections including the Recitals, Definitions, Grants of Right, and Exhibits and Attachments.

Detecting Related-Parties within an Agreement

Licensing Party information is most often located in an agreement's Introduction, with the exception of the filing company, which would be part of the filing details. Within the agreement, it is prudent to also review the Miscellaneous section, if there is one, to be aware of any

additional information that is being disclosed regarding relationship of the agreement parties. Additional external research into party relationships is often required to complete due diligence.[2]

Validating Relevant Dates

Effective Date details tend to be in an agreement's Introduction, but may also reside in the Definitions, Signatures or Term section. The Term details will generally be documented in the agreement's Term or Definitions section but will often appear in the Grants of Right(s) if perpetual in duration.

Validating Market

The Industry(s) related to an agreement can typically be deciphered from context provided in the Recitals or Definitions section, or from the Exhibits and Attachments. This is one of the most critical comparability factors and yet often one of the most time-consuming terms to decode directly from the license agreement as it may require external research into the business and products of the licensing parties. SIC code details filed with an agreement record may not relate to the intangibles being licensed, so analysts should not rely on this for validation without further investigation.

Validating Geographic Impact

Territory terms tend to be contained in an agreement's Definitions section or in the Grants section. If the list of territories is extensive, this information may appear in an attachment in the Exhibits and Attachments section. Exclusivity information is most often found in the Grants section. Exclusivity can be more complex that appears from an agreement summary as some documents contain additional conditions such as sales milestones that must be met in order to maintain the licensee's rights to a particular exclusivity level.

Determining Reasonable Royalty Rate(s)

Royalty rates tend to be captured in one of the more intuitive sections of an agreement with labels (e.g., Payments, License Fees, Considerations) that are clear indicators of their contents. This section may also detail collateral transactions such as lump sums and milestone payments that may impact the results of an analysis and/or the overall comparability of the license agreement to the tested transaction. Analyzing all royalty rates in an agreement is vital determining whether specific adjustments should take place to calculate an effective royalty rate.

CONCLUSION

Moving forward, analysts will be tasked with how to efficiently and meticulously conduct analysis of intangibles license agreements. Since no two intangibles license agreements are constructed identical, the process can often be an arduous one for even the most seasoned analyst. Utilizing this two tiered approach provides additional defensibility when providing final results to a team, client, or in the courtroom.

[1] The following sections reference Exhibit 1 – Summary of Intangibles License Agreement provided by ktMINE

[2] The author typically suggests a thorough review of each the licensee and licensor from various sources as part of conducting due diligence.