Unlocking the Black Box of Business: Licenses

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Background

- Thomas McMurry
  - Director, Business Development
  - 3+ years at BU
  - BS, MS, PhD Chemistry
  - 5 years @ NIH/NCI
  - 25 years in Cambridge Biotech
Acknowledgements

- Michael Pratt, MBA
  - Managing Director, Office of Technology Development at BU
What is a license?

*BLACK’S LAW DICTIONARY*

n. 1 A revocable permission to commit some act that would otherwise be unlawful; esp. an agreement (not amounting to a lease or profit à prendre) that it will be lawful for the licensee to enter the licensor’s land to do some act that would otherwise be illegal, such as hunting game. See SERVITUDE. 2. The certificate or document evidencing such permission.

-- license, *vb*

*......it’s like renting your house.*
What and why?

What?
- Patents, Copyrights, Trademarks, Products...

Why?
- Encourage commercial development
- Monetize underutilized assets
- Consideration to access another market for your own products
- Build value in your startup company to attract further investment...
How does licensing work if I wish to start a company based on my BU invention?

BU inventions are governed by the Boston University IP Policy

- You inform OTD about the possible invention
- OTD determines if it is patentable, copyrightable
- OTD determines whether or not to file a patent  [limited budget!]
- If a patent is filed, OTD works collaboratively with the inventors to establish a licensing strategy
- If the inventors wish to start a company, our preferred licensing path is ALWAYS to the BU inventor’s startup
- NOTE: The company should be prepared to assume license obligations [patent costs, product development etc]
Summary: Types of Licenses

In-Licensing
- Acquiring the right to develop and sell a product
  - Enabling license – patents + know-how
  - Freedom to operate – route through toll gates erected by blocking patents

Out-Licensing
- Granting rights to intellectual property to others
  - Enabling license – giving up a product to someone with more resources
  - Freedom to operate – extracting value from a platform technology

Cross-Licensing
- Trading IP rights
  - Mutual elimination of road blocks
  - Competitive or non-competitive products
  - Many patents filed to serve as trading chips at the table
Some major issues to worry about

- Exclusivity vs. non-exclusivity
- Field of Use
- Time/Geographical limits

- **Royalty**
- **Equity**
- **Other fees and costs**
- **Milestones**
- **Claw-back provisions**
- **Auditing**

What the licensee gets:

- Royalty
- Equity
- Other fees and costs
- Milestones
- Claw-back provisions
- Auditing

What the licensor gets:

- “Trust but verify”
Common goals, different perspectives

- Clear context and agreement framework
- Develop strong IP protection, stop infringers
- Enable the licensee to make, use, and sell the product
- See the product reach the marketplace as soon as possible
- Fairly allocate income from the technology’s success
- Allocate liability as appropriate
- Define procedures for managing the license (disputes, termination etc)
Different Degrees of Rights Can be Granted

Degree of transfer of rights

Complete transfer

Limited transfer

No transfer -- immunity

Assignment

License

Freedom from Suit

Exclusive

Exclusive by Field

Exclusive by territory

Non-exclusive

Immunity = no Tribal Council
(Federal District Court)

Degrees of Exclusivity
Where is Value Extracted in a License?

- Upfront fee
- Ongoing pre-commercial payments
  - Patent costs
  - Milestone payments
  - Annual Minimum Royalties
- Research collaboration and support
- Sublicense income sharing
- Earned royalties
Ongoing Pre-Commercial Payments

- Patent costs
- Milestone payments
  - Reflects increase in value of technology to licensee as they make progress
  - More common with life sciences inventions
  - Development milestones
  - Patent milestones
  - Sales milestones
  - Can be in stock
- Annual Minimum Royalties
  - Due diligence mechanism
  - Typically escalate substantially after 3 or so years
  - More common with physical sciences inventions
Royalty Rate

- The main post-commercialization economic component of the license
- Biggest long term impact if the product is successful
- Offsets
  - Major downward impact
  - Credits for:
    - Current year annual minimum royalties  YES
    - Prior year annual minimum royalties  NO
    - Sunk patent costs  NO
  - Offsets for royalties paid to third parties  SOMETIMES
- How are sales by Sublicensees handled?
  - Identical to sales by licensee
  - Excluded and handled under Sublicensee income sharing, Licensor receives a higher % on revenue received by Licensee from Sublicensee (e.g. 20% vs. a 5% royalty on sales by Licensee)
How do you get equity in a license?

- Substitute for one or more cash components
  - Remember -- “Equity is just cash that hasn’t turned green yet”
- Generally the upfront fee
  - For the technology
  - For other value contributed if a start-up you’re helping create the company
- May allow early milestone payments in stock
Milestones

- As a licensor, you’d like to know what your licensee is up to -- or not
- Generally should have some reporting requirements
- Milestones lay out an agreed-upon plan for the future
  - Development Milestones
  - Commercialization Milestones
- Sometimes a Milestone can just be money paid

Here’s the money, now go away
Claw-back

- What is the worst-case scenario and what happens then?
- Licensee goes belly-up
- Licensee has lost interest
- Licensee isn’t making payments
Royalty under-reporting is very common

Figure 1: Percentage of Licenses with Underreported Royalties

Auditing can be well worth the effort; 73% of audits recover 10X-100X of audit cost*

Debora R. Stewart, CPA and Judy A. Byrd, CPA* Invotex Group
Negotiation process

- May start with a business plan overview by the potential licensee
- Confidentiality agreement may be required
- Offer is typically made via a Term Sheet that contains financial terms and other select/critical terms, may or may not be binding
- Milestones lay out an agreed-upon plan for the future
- Once term sheet is agreed upon, an actual license agreement is drafted
- The language of the agreement is then negotiated
- Often other documents/deliverables are required for closing
- Can be helpful to have checklist of these to keep track of them
- BU template “start-up/express” license available online