

Controversies in the Licensing of Future Improvements

What is an improvement?

In the context of a license, an improvement is something that improves the technology that is the original subject of a license. Unfortunately, an improvement can only be defined by employing similarly vague terms: an enhancement, modification, alteration, etc.

Despite this vagueness, what is an improvement is well understood, and for any specific technology can be readily recognised: it is knowledge that improves the technology that is the subject of a license.

The controversy in a license is not so much how to define it, but whether it should be:

1. automatically licensed to the licensee, captured by the terms of the original license, without any additional financial compensation to the licensor, or
2. licensed, but only with some additional financial compensation to the licensor, such as an increase in a royalty rate or license fees.

Licensee's perspective

It is in a licensee's interest to be licensed improvements. To have access to improvements will enable to the licensee for example, to produce a better product, produce the product more efficiently, or at less cost. Whatever the improvement is, by definition, it must be to the licensee's advantage to have access to it. It might make the licensee more competitive, or it may contribute to an increase in sales, or an increase in profits, or other benefits.

A licensee will typically seek to have the original license make provision for:

1. an obligation upon the licensor to promptly disclose improvements to the licensee
2. the license to operate so that the improvement is licensed from the time of its creation, without the need to negotiate further terms nor to negotiate a variation to the original license
3. the improvement to be provided free of any obligation to pay additional royalties or license fees.

Licensor's perspective

It is also in the licensor's interest to license improvements to the licensee. A better equipped licensee may be able to sell more products, or sell them at an increased price, and in turn, this will translate into increased remuneration to the licensor, usually in the form of increased royalties.

A licensor however, will not so readily be prepared to assume that providing access to an improvement should always be without additional royalties or license fees.

Does an improvement justify additional royalties?

A licensor would normally agree with the principle that small incremental improvements to the licensed technology are unlikely, by themselves, to have a value that justifies additional royalties or license fees. But a licensor would be reluctant to assume that all improvements will be small incremental improvements that will not warrant a change to the financial terms.

An improvement may add such significant value to the licensed technology that it might not be equitable for it to be provided without additional remuneration.

Suppose a license is granted of a compound where research supports that it has properties to make it a candidate for a drug for the relief of back pain, applied topically, with a value assessed as commanding a 7% royalty. Suppose that the licensor's further research, undertaken at the licensor's

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own expense after the license is granted, indicates that the compound could additionally assist in the relief of osteoarthritis pain, and even more, indicates that it has a regenerative effect on joints affected by osteoarthritis, with a value assessed as commanding a 12% royalty

In these circumstances, it would not be equitable upon a licensor for royalties to be limited to 7% on sales of both a back pain drug as well as an osteoarthritis drug. The licensor's equitable remuneration should be a 7% royalty on sales of a back pain drug, and a royalty of 12% on sales of an osteoarthritis drug.

The improvement on this example, namely the further osteoarthritis clinical indication has an additional value of 5% (12% - 7%).

This analysis can be applied beyond biotechnology. The analysis equally applies across all scientific fields: to information technology, engineering technologies, medical devices, etc.

Boundary between improvements that do, and do not justify additional financial terms

More often, an improvement will be an incremental small improvement that does not merit any additional remuneration to a licensor. On these occasions, the license according to its original terms should facilitate the improvement being captured by the original terms of the license, and immediately licensed to the licensee, without additional royalties or license fees.

But from time to time the improvement will not be a small incremental one, but a major improvement that justifies the license not immediately capturing the improvement, and it being made available to the licensee only if the warranted additional remuneration is to be paid, in the form for example, of additional royalties or license fees.

So, where is the boundary:

1. up to which an improvement is automatically captured and licensed according to the original terms of the license, without additional financial compensation, and
2. beyond which it is not captured under the original terms of the license, but subject to negotiation, may be licensed to the licensee, for additional financial compensation?

Sometimes, the boundary is identified by reference to a test of infringement: Would the use of the improvement infringe the original licensed technology? If the answer is "Yes", it is automatically captured and licensed according to the original terms of the license, without additional financial compensation. If the answer is "No", it is not automatically captured, but subject to negotiation, may be licensed to the licensee, for additional financial compensation.

The trouble with this being the boundary is that it is hard to conceive of an improvement the use of which does not infringe the original licensed technology. By definition, being an improvement, it would have to.

An alternative boundary employs a test of novelty: Is there sufficient novelty in the improvement for the improvement to be separately patented? If the answer is "No", it is automatically captured and licensed according to the original terms of the license, without additional financial compensation. If the answer is "Yes", it is not automatically captured, but subject to negotiation, may be licensed to the licensee, for additional financial compensation.

There is a flaw in this approach, and that is that the question of sufficient novelty may not be finally determined until a patent is examined, granted, and the relevant opposition period expired. But even then it is a more reliable test. Commercially, the licensor and licensee will make a decision about the likely outcome of the novelty test, and with the assistance of expert advice, it is likely that they will come to a shared view on whether there is sufficient novelty.

This test of novelty, to determine the boundary between a captured improvement that does not deserve additional financial compensation, and an uncaptured improvement that can be negotiated to be included in the license, with additional financial compensation, is a more reliable, and more equitable test to determine which side of the boundary an improvement lies.