

## Loaded questions to watch out for (or to ask) in a license negotiation

From time to time *IP bits* will present “Loaded questions to watch out for (or ask) in a license negotiation.” This edition of *IP bits* contains the first two.

We will look at questions that are loaded in some way, and which are designed to secure an advantage to the questioner, or to seek to create a disadvantage to the responder.

The loaded question may be asked by a licensor, or by a licensee, depending on the question. We will look at the question, how it is loaded, and suggest some strategies for dealing with it.

### **Loaded Question #1: Licensee to Licensor: “Can you tell me what royalties you are expecting?”**

At some stage in the license negotiation financial terms have to be addressed.

Sometimes however, this question is asked at a very early stage in the relationship, before the negotiation even commences, or just as it starts, so early in fact that a licensor might be taken by surprise by the question being asked at that early time.

Why does a licensee ask that question so early in a license negotiation?

It may be because the licensee wants to know the “ballpark” of financial terms before commencing expensive and time consuming due diligence.

Or, it may be to secure an advantage. A licensee may perceive the licensor to have a weak bargaining position. This may be because, for example,

1. the licensor seeks to license out at an early stage in the development of the technology
2. the licensor may be a university or research organisation, and may be assessed by a licensee to have limited other options, or even no other options
3. the licensor may have been searching for a long time for a licensee, and is perceived to be anxious not to lose the present opportunity it has.

What does a licensee seek to achieve by asking that question so early in a license negotiation?

Where the technology is early stage, or where the licensor is a university or research organisation, or otherwise perceived to be anxious, the earlier the question of the licensor’s royalty expectations is asked, the weaker the licensor’s bargaining position is perceived to be.

A licensor does not want to ask for too much, in case doing so makes the potential licensee uninterested. A licensor might, at such an early stage, respond by stating a royalty, or a royalty range, which is at the low end of the commercial spectrum for the technology concerned. The licensee of course will respond by replying that the licensor’s expectation is too high (whatever the licensor stated), but that the licensee is sure something can be negotiated.

As a result the licensee has achieved its objective of the opening offer for a royalty rate being low, and being able to be negotiated down further.

How should a licensor deal with such a question when it arrives at such an early stage?

The licensor should sidestep the question, and should not respond to it. There is no need to conceal the lack of readiness to negotiate, and every reason to be candid. That is especially so where a licensor must still undertake steps to be fully prepared for the financial negotiation.

“We haven’t quite finished our financial analysis for the license, so I can’t meaningfully answer that today”.

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The object is to defer the negotiation to a time of one's own choosing, when ready to negotiate, and not to be drawn prematurely into a negotiation of financial terms.

Indeed, even if the licensor was ready to negotiate financial terms, a licensor doing so when the licensee perceives the licensor to have a weak bargaining position will disadvantage the licensor. It would be better for the licensor to defer the license negotiation until a time when the licensor has negated any such perception on the part of the licensee.

### Loaded Question #2: Licensor to Licensee: "Can you tell me what your sales forecasts are"

A licensor that asks this question is seeking information from a licensee. It could be to enable the licensor to judge how committed, or how confident the licensee is in its commercialisation of the licensed product and its penetration of the market place.

It could also be to assist the licensor formulate minimum performance obligations that will be sought from the licensee, that the licensee must achieve, such as minimum sales to be made, or minimum royalties to be paid, otherwise its license might be terminated.

When a licensor is in a weak position, a licensee will typically decline to answer, not wishing to commit itself. The licensee might also succeed in resisting minimum performance obligations such as minimum sales or minimum royalties.

But, where a licensor is in a stronger bargaining position, with a number of licensees to choose from, the licensee will need to perform well in its dealing with this question.

The licensee will not want to respond too conservatively. The risk is that if it does, a competing licensee might be preferred by the licensor. The licensee will not wish to respond too optimistically either. This could have the result that the licensor might dismiss the licensee as being fanciful, and prefer another licensee.

An optimistic response might also be the basis for the licensor formulating minimum sales obligations, or minimum royalty obligations, based on the licensee's optimistic response.

If the licensee's response is too optimistic, it will afterwards be difficult for the licensee to argue that it is not able to achieve the forecasts it had estimated. The result could then be the licensee finding it hard to resist very onerous minimum performance obligations in relation to the optimistic sales quantities, or high minimum royalties based on those optimistic sales forecasts. The licensee's dilemma is that it doesn't want to forecast too high, nor too low, each carrying its own disadvantages.

How might a licensee consider responding?

A response has to be considered. Again, the question may be asked at a time when the licensee has not completed an assessment or analysis of the market to enable reliable forecasts to be made. One strategy therefore is to not respond, and to defer responding until a considered assessment has been made.

Another strategy is to focus on a different type of performance obligation, rather than the risky minimum sales, or the equally risky minimum royalty obligations. A licensee's assessment of the market may not be able to result in a reliable forecast. A licensee therefore may assume great risks, of making an investment, and termination of the license, if it cannot achieve the minimum sales. But what the licensee can assess with confidence is the amount of the licensee's investment in the technology. The licensee can reasonably accurately forecast how much it will spend on its future development, and how much it will spend on its marketing campaigns. The licensee can consider binding itself to this predictable low risk performance obligation, instead of the higher risk minimum sales or minimum royalty obligation. It can also make these minimum investment obligations conditional on technical and regulatory success.

"The market and competitors are unpredictable for firm sales estimates. But what we can commit to is to invest a minimum amount in R&D, and marketing campaigns during the first 2 or 3 years."