

# **To License a Patent – or, to Assign it: Factors Influencing the Choice**

**Philip Mendes**  
Partner  
Innovation Law  
Level 3, 380 Queen Street  
Brisbane, QLD, Australia  
philip@innovatiuonlaw.com.au

## **Introduction**

Other than by a holder of a patent itself exploiting that patent, licensing is perhaps the most likely, and therefore most common commercialisation pathway.

But, sometimes, the assignment of a patent can be a pathway to commercialisation that not just warrants consideration, but in fact, depending upon the occasion, may be the more desirable or even necessary pathway.

On each occasion, the appropriateness or inappropriateness of licensing, or assignment, needs to be considered.

Sometimes an assignment is mandatory, such as where employee inventions are assigned by an employee to the employer, or, in some circumstances, by an employer to an employee, and a license is simply inappropriate.

In focus here is assignment or licensing as a commercialisation pathway.

Neither should be considered as being the automatic commercialisation pathway.

Depending upon the needs and expectations of the patent holder, and the person with whom a deal is proposed, either licensing or assignment may present a better pathway, or a more remunerative pathway, than the other.

Some of the factors that may influence choosing licensing or assignment on a particular occasion are considered below.

## **What is licensing ?**

Licensing occurs when a licensor grants exploitation rights over a patent to a licensee.

A license is also a legal contract, and so it will set out the terms upon which the exploitation rights are granted, including performance obligations that a licensee must comply with.

A license being a contract with those performance obligations, the failure to comply with those obligations may lead to the termination of the license, and the reversion of exploitation rights back to the licensor.

A license is therefore revocable.

## **What is assignment ?**

In contrast, an assignment is irrevocable.

An assignment involves the sale and transfer of ownership of the patent by the assignor to the assignee.

This transfer of ownership is permanent and irrevocable.

Just as when any other asset or property is sold, its sale results in the former owner being permanently divested of that ownership.

## **Royalties**

If the revenue strategy sought is royalties, licensing is the most common, and most prudent commercialisation pathway.

Royalties are typically paid over the life of the patent, such as the unexpired 20 year term of a patent.

Royalties therefore have the prospect of being maximised in a license, over that term.

Where royalties are sought on this long term basis, an assignment of a patent would not be the most prudent commercialisation pathway, and that is so for a number of reasons.

In a license, the failure to pay royalties will be a breach of the license contract, and would entitle the licensor to terminate the license.

This is an important contractual provision in a license operating to deter a licensee from breaching the royalty obligation, since its breach may result in the loss of the licensed rights. This important deterrent is very valuable to a licensor, and why, as a rule, royalty expectations are best served with a license, and not an assignment.

That deterrent would be absent if the patent was to be assigned.

An assignment being a conveyance of title in a patent that is permanent and irrevocable, an assignee that fails to pay royalties does not risk the loss of rights in relation to the patent, since the assignee owns the patent unconditionally.

The failure to comply with the future royalty obligations, while actionable with the recovery of damages for non payment, does not put at risk the intellectual property rights which have been irrevocably transferred

This is why it is undesirable to assign a patent for future royalty payments.

## **Lump sum sale price**

An assignment may be appropriate however where the patent owner prefers to receive a lump sum price, at the time of the assignment, rather than collecting royalties.

The payment of a lump sum may be a term of a license contract. However, if only that sum is paid, and royalties are not payable, it will generally be regarded by the person paying the lump sum as being a purchase price for the patent. The person making such a payment will therefore be likely to seek a permanent and irrevocable assignment, instead of a revocable license contract with conditions.

This will be so where the payment of the lump sum relates to the whole of the unexpired period of the patent.

Where the lump sum payment relates to a lesser period, then assignment would be inappropriate, and instead there should be a license for the period that relates to the actual lump sum payment.

Royalties may be received over a period up to 20 years for example, in the case of a patent.

In that case, the patent owner runs the risk that over that very long period there may be technical failure, market failure, regulatory failure, or even a competing product that enters the market and erodes the royalties that might otherwise have been paid.

Rather than risk uncertain royalties with a license, the patent owner may prefer to receive a once only lump sum payment, at the outset, receiving all the value of the patent in this way on one single occasion only.

This may be an occasion when assignment may be preferable to a license.

By assigning, the patent owner transfers these risks of reduced royalties in the event of technical failure, market failure, regulatory failure, and competing products, to the assignee.

The once only lump sum payment that the assignor receives is not refundable if these risks should eventuate.

The disadvantage to an patent owner is that the lump sum amount at the time of the assignment will be assessed on the value of the patent at that time.

This means that these risks will be factored into the lump sum price, as will a discount rate for the immediate benefit of a sum of money which if paid otherwise as royalties would have been over time a greater dollar amount.

Another disadvantage is that the patent owner, by assigning, ceases to have the prospect of blue sky financial return should the patent have otherwise generated greater royalties than the lump sum amount has been assessed on.

These disadvantages however need to be weighed up against the advantages of a once only lump sum price.

The capital value of a patent that is assigned may be a very substantial amount of money.

Receiving a capital lump sum can be extremely advantageous to an assignor.

The assignor may have the need for capital. The assignment of a patent can provide an excellent opportunity for raising that needed capital.

The assignor in need of capital may otherwise have had to raise debt capital, with repayment obligations to the lender, as well as interest obligations.

Often, debt capital in this way is difficult to raise because conventional lenders are reluctant to regard a patent as adequate security for borrowings.

Or, where the assignor is a company, it may otherwise have had to raise equity capital, by issuing shares in return for the capital subscribed, with the a result that the assignor's existing shareholders would be diluted.

Selling a capital asset such as a patent for a once only lump sum amount may sometimes be a more attractive capital raising option than raising debt capital or equity capital.

For example, a start up company such as a biotechnology company researching and developing a patent to take it to state of development where it can make a commercial deal, may choose, instead of licensing the patent, to assign it, and in that way raise substantial capital to fund further research and development of other patents in its portfolio.

Assigning for a lump sum will not always be a prudent course, but it sometimes may be the most prudent course to take.

### **Start up companies**

A start up company, in the sense in which that term is employed here, is a company with speculative venture capital investment, where the venture capital investors will typically be seeking an exit from their investment in a 3 to 5 to 7 year timeframe.

Typically, the start up company's patent has been made available by a technology developer, such as an individual, or a university, research institute or government laboratory.

The investment made into a start up company has as its purpose to take the state of development of the company's patent to a level where an exit opportunity arises.

An exist opportunity for a venture capital investor will typically be by listing the company upon a stock exchange, or to trade sell the assets of the start up company.

Both exit opportunities are maximised, according to venture capital investors, if the start up company owns the patent made available by the individual, university, research institute or government laboratory, rather than just a license.

There are a number of reasons for this perspective by a venture capital investor.

Firstly, raising investment capital in the pre listing stage is perceived by capital raising professionals to be more easily done when the start up company owns its major asset, namely the patent, rather than just has licensed rights to it.

Secondly, the listing of a patent owning start up company, and the raising of public capital in an initial public offering is also perceived by capital raising professionals, and venture capital investors, to be a more attractive investment proposition to the public from whom capital is sought, than comparatively when the start up company only has a license.

Thirdly, if instead of listing the exist is a trade sale, venture capitalists perceive that a sale of the patent asset that is owned is much easier than the sale of a license to that patent.

Given that the start up company will typically develop new patents as its own asset, there is also a negative perception where the start up company's patent is partly licensed in from the individual, university, research institute or government laboratory, and partly owned by the start up company.

There is a more positive perception when all the patent is owned, instead of it being in part owned and in part licensed.

Typically, the individual, university, research institute or government laboratory making its patent available to the start up company does so, not for royalties, but instead for shares in the start up company.

In this way, the financial expectations of the individual, university, research institute or government laboratory are aligned with the investors, namely a return is realized from increased share value, not from royalties payable in relation to product sales.

As a result, the absence of royalties does not make it essential that the individual, university, research institute or government laboratory consider only a license.

Given that the patent is made available for shares, not royalties, and given the desirability of maximising the exit opportunities and exit terms, for both the venture capital investor, and the individual, university, research institute or government laboratory shareholder, it might be considered prudent to assign the patent to the start up company, and not just to license it.

## **Performance obligations**

A license of patent typically contains performance obligations upon a licensee.

These performance obligations will be of two types: pre market entry milestones, and post market entry sales targets.

Pre market entry milestones require a licensee to achieve or meet the agreed milestones. The milestones may for example be: undertaking a trial or validation, producing a prototype, producing a pilot plant, meeting regulatory requirements, progressing through clinical trial phases, etc.

By achieving or meeting those milestones, the licensee travels the pathway to market entry, and continues to enjoy the licensed rights.

If the licensee fails to achieve or meet those milestones, the licensor may terminate the license, with reversion of the patent back to the licensor.

In this way, a licensor ensures that the licensee does not shelve the patent, that is, does not become an inactive rights holder, with no commercialisation, and no financial benefits back to the licensor.

A licensee, for any number of prudent commercial reasons, may not progress the development of the patent.

A licensor will be concerned that without pre market entry performance obligations, the shelving of the patent by the licensee will result in there never being market entry, and result in the licensor not earning any royalties.

Sales targets are performance obligations which commence once market entry has occurred.

Sales targets require a licensee to achieve minimum sales of products and services by which the licensed patent is exploited.

By having sales targets in this way, a licensor ensures that there is exploitation by a licensee to at least the minimum extent represented by the minimum sales targets, and this in turn ensures that the licensor can expect the minimum royalties represented by those minimum sales targets.

Performance obligations like these pre market entry commercialisation milestones, and sales targets are a critical part of the obligations upon a licensee in a license.

Failure to achieve these performance obligations typically results in the termination of the license, with reversion of the patent back to the licensor, and the licensor then being able to license the patent to another person that does have the capability to meet these performance obligations.

However, putting performance obligations such as these in an assignment is a challenge.

Not unexpectedly, an assignee, having purchased the patent, will have the view that performance obligations such as these are inappropriate.

Further, an assignment of patent being absolute and irrevocable, termination for failure to meet performance obligations is not possible.

Accordingly, where performance obligations such as pre market entry commercialisation milestones and sales targets are sought, and this invariably occurs when long term royalties is the remuneration to the grantor of commercialisation rights, a license is the prudent commercialisation pathway to follow, not assignment.

## **Conclusion**

Licensing is not necessarily always the best or most advantageous commercialisation pathway. Sometimes, assignment might be.

Similarly, assignment is not necessarily always the best or most advantageous commercialisation pathway. Sometimes, licensing instead might be.

On each occasion an assessment of the advantages and disadvantages of assignment versus licensing needs to be made.

Neither is necessarily the better course to take to the exclusion of the other. The benefits of royalties, as against the benefits of receiving a once only lump sum need to be assessed, with all other implications, to reach a conclusion whether on a particular occasion, a license, or an assignment is to be the preferred course.