Technology Transfer Tactics™

*The monthly advisor on best practices in technology transfer*

# TTOs often walk a fine line when negotiating rights to improvements

Dealing effectively with the rights to IP improvements in your license agreements can be a tricky task, since both your TTO and prospective licensees have good reason to want those rights. If your office is like most, you probably seek to negotiate ownership of all improvements that are dependent on the claims of your licensed seminal patents so that, in the event of early termination, you'll have improvements available to assist in relicensing.

But many licensees may balk at giving up improvement rights, hoping any future IP development will enhance their IP estates and potentially ward off future competition. And even when you do get the improvements in the license agreement, what seems ironclad to you may look like a prime opportunity for challenge by your licensees, especially when there's a lot of money at stake.

Time to declare war to protect your interests, right? Probably not, tech transfer executives say. Claims over rights to improvements often require careful negotiation, rather than aggressive legal action, because at the end of the day both sides want the technology to be commercialized.

The issues involved are typically straightforward, and both sides generally have a good point to make in the quest for improvement rights, notes **Charles R. Macedo**, partner at Amster, Rothstein & Ebenstein LLP, New York, and author of The Corporate Insider's Guide to U.S. Patent Practice (Oxford University Press). "Typically there is a choice to be made as to what technology is being licensed," he confirms -- the existing IP only or the future improvement of that technology as well. "When a licensor is 'in the business' and is putting a licensee 'into the business,' often the licensor may want to get at least a license back, if not an outright assignment, from the licensee to any improvements made. The theory is that but for the license, the licensee would not be in the business and thus would not have made the improvement."

On the other hand, from a licensee's perspective, "having access to any improvements made by the licensor may or may not be important. The advantage of getting improvement rights up front is it avoids the need of paying for a second license." The downside is that it may make the license more expensive, he adds. As in all negotiations, giving in one area often lets you take in another, and improvement rights can be used as leverage for concessions on price and other negotiating points.

"The driving factor on this type of arrangement may turn on what type of technology is being licensed, how mature it is, the likelihood of either party's making improvements, and the costs of obtaining rights to improvements," he notes. "The impact is not merely license fees, but also freedom to operate issues."

Adds **Jim Baker**, PhD, executive director of innovation and industry engagement at Michigan Technological University in Houghton, "the licensee generally wants to avoid royalty stacking, where the licensor piles royalties on top of the previously agreed-to rates for incremental technology improvements -- or, worse yet, being stuck with a license to an inferior technology if the improvement gets licensed to their competitor."

## *Cases in point*

To help illustrate the push and pull often at play with improvements rights, here are several examples of how disputes can arise.

**Case 1**: One university licensed technology for drilling with a specific water-metallic element mix.

The licensee developed a modified method of mixing the ingredients -- but did not alter the ingredients themselves -- and said it owned the rights to that improvement because it was not conceived of nor included in any of the language in the patent. The university maintained the patent covered the mix and the method of using it to drill. Problem was, the licensee couldn't secure additional funding needed to move the technology forward without some degree of ownership of the new mixing method. Says a tech transfer executive involved in the conflict: "We want the technology to be commercialized, so we'll do it, but it's very troubling that we have such arguments. We of course want the licensee to get funded, so we'll probably compromise."

**Case 2**: A university licensed an aerospace technology, and the company formed around the patent was acquired by a larger company -- which tried to claim all improvements back to time the university signed the license. A TTO executive there comments: "We stood firm on the grounds that all the improvements up to the time of the acquisition belonged to us. We didn't own anything that belonged to the acquirer, and we didn't claim to. But the acquirer -- a multi-billion-dollar-a-year enterprise -- wanted to make it clear that improvements it made were not owned by us." In that case as well, the university's stance on rights to improvements represented "the blockade in the acquisition taking place." Adds the TTO executive: "We're making sure it's very clear what we're agreeing to in the acquisition because we own stock in the company being acquired, so we'll have a liquidating event, but we'll also have royalties going forward."

**Case 3**: "University license agreements typically follow the 'ownership is determined by inventorship' model," notes **David J. Aston**, with Peters Verny LLP, Palo Alto, CA, "and improvements may be made by either the university or the licensee. It can become problematic for the university when improvement inventions surface with joint inventorship between company scientists and university scientists. Then the university only co-owns the improvement." Worse, from the university's perspective, a faculty scientist may make improvements as a consultant to the company, meaning the university has no ownership. "There are ways to address those issues during the license negotiation and drafting," Aston adds, "but typically the parties 'finesse' the issue to get the deal done."

## *Finessing the issue*

That's often the bottom-line situation, notes **G. Michael Alder**, director of the TTO at Brigham Young University, Provo, UT. "Universities in rights to improvement disputes are often leveraged by the fact that there's an event about to occur that's beneficial to the licensees, so they need to find a way to make the arrangements work," he tells *Technology Transfer Tactics*. "Universities are motivated -- and generally the other parties are motivated, too -- so they keep going back and forth until they arrive at a mutually agreeable solution. People who are funding research are trying to get more access and more ownership. We're just trying to find more effective ways of dealing with them."

That generally means compromise -- but not on every question. "I would be surprised if any licensee agreed that a licensor would be entitled to improvements made by the licensee," notes **Wesley D. Blakeslee**, executive director at Baltimore-based Johns Hopkins Technology Transfer. "Right to improvement requests in our office usually arise in the context of the licensee requesting that any improvements made by the inventors at JHU in the future be rolled into the license. We can't agree to that. From our standpoint, we try to get any data and results given to us if the licensee terminates the license and returns the technology to us to help in relicensing."

Still, there are usually ways to come to some sort of agreement, Baker says. "There is a meaningful middle ground," he comments, "but where that is depends on the circumstances. It is important that both sides are sensitive to the legitimate concerns of the other." What exactly an "improvement" is can be ambiguous, he explains, and ambiguity in contracts is simply deferring a dispute to the future. So "clear and objectively definable definitions are very helpful to having a mutually comfortable middle ground," he advises. "For example, improvements can easily be defined to be limited to future patents that are owned by the licensee and require freedom to operate under the currently licensed patents. The university couldn't license such patents anyway, so it isn't giving up much but is risking that a new patent will be sub-

stantially more valuable than the previously licensed patent -- although that value would be tough to realize because of the freedom to operate issue."

A moderate extension of that approach would be to define improvements to include patents that are related to a specific application -- such as utilizing a specific physiological mechanism to treat or prevent a specific condition, or using a specific class of materials to achieve a particular objective.

One issue that also needs to be worked out is the possibility that a different research group on campus will create something that could be viewed as an improvement, Baker continues. "That improvement could be subject to rights granted to a third party, for example, under a sponsored research agreement," he says. "It's important to be careful to avoid obligating future inventions that are created by others within the university and that may have rights held by others."

Comments **Ronald I. Eisenstein**, a partner at Nixon Peabody, Boston: "If an improvement makes the technology more likely to be commercialized, you get a better return on your dollar. That's why when people are working together, it's not necessarily a problem." The problems arise, he says, "when somebody starts saying, 'I want an improvement from somebody else's lab that you never considered giving.' But if you don't have sloppy contract language, that issue won't come up."

Similarly, Baker adds, the fact that faculty move to new positions at other schools needs to be considered, and improvement language should account for that and not risk providing rights beyond the scope of what the university is able to offer.

Says Alder, "There's got to be give and take. A lot depends on the leadership at the licensee company you're dealing with, because some have ironclad policies that they will own all IP -- or they won't do a deal. When you get into that situation, sometimes you have to walk away." He cites the case of a faculty member at one university who developed a way to immediately and permanently sequester CO2 deep underground, to make power plant effluent much safer. A group of companies wanted the technology, and planned to kick in something like $750,000 for the faculty member as part of $400 million in funding -- but they demanded all the IP. The university's TTO was placed in the unenviable position of telling the inventor that giving up IP rights was a precedent it just couldn't live with.

## *Positive relationships matter*

The bottom line, Eisenstein points out, is "if you have a good relationship, no one on either side is going to over-reach. It's when you have a bad relationship to begin with that you get into these problems. A right to improvement dispute is usually one of several. It may be the first one you hear somebody complaining about, but by the time you see it, there are usually other issues going on. The right to improvements dispute may be the first visible sign that your relationship with the licensee is not going well."

While TTO counsel need to be involved, because the details of the contract language are "critically important," according to Baker, "the role of the TTO is to foster the relationship with the company, develop a clear understanding of the legitimate needs and wants of both sides, and work with counsel to develop terms that meet the needs and addresses the wants as much as possible. That applies to improvements as well as all other elements of licensing."

Adds Eisenstein: "When people are getting along and want to work together, there shouldn't be a fight. If you've made the decision to license to somebody, you want to see that party succeed. Conflicts arise when you don't feel that the licensee is doing a good job with the technology you've licensed. You try to cover that with due diligence requirements, but that's where you're going to see a conflict arise."

*Contact Macedo at 212-336-8074 or cmacedo@arelaw.com; Baker at 906-487-3459 or jrbaker@mtu.edu; Aston at 650-324-1677 or djaston@petersverny.com; Alder at 801-422-6266 or mike_alder@byu.edu; Blakeslee at 410-516-8300 or starman@jhu.edu; and Eisenstein at 617-345-6054 or reisenstein@nixonpeabody.com.* ▶