BOSTON PATENT LAW ASSOCIATION

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NEGOTIATING UNUSUAL TECHNOLOGY TRANSFER BUSINESS ARRANGEMENTS

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INTRODUCTION:

BUSINESS ARRANGEMENT MUST BE FLEXIBLE TO SATISFY NEEDS OF BOTH PARTIES

A. BOTH PARTIES MUST WIN
   1. IN LONG-TERM RELATIONSHIP, SUCH AS
      A. LICENSE
      B. JOINT VENTURE
      C. DISTRIBUTION AGREEMENT
      D. MANAGEMENT CONTRACT
   2. IN SHORT-TERM RELATIONSHIP WHEN PLAN TO HAVE OTHER RELATIONSHIPS IN FUTURE WITH SAME PARTY
   3. WHEN PAYMENTS ARE TO BE MADE OVER SUBSTANTIAL PERIOD

B. IF ABOVE ARRANGEMENTS ARE TO BE SUCCESSFUL, BOTH SIDES MUST MAKE MONEY

C. IF PARTY WHICH MUST PERFORM OVER LONG-TERM AND MAKE LONG-TERM PAYMENTS TO OTHER PARTY, DOES NOT HAVE SUFFICIENT INCENTIVE TO WORK HARD (SUCH AS LICENSEE), PARTY WHICH WOULD RECEIVE PAYMENTS (SUCH AS LICENSOR) WILL NOT RECEIVE AS MUCH

D. IF AGREEMENT IS NOT A GOOD DEAL FOR BOTH PARTIES, ONE PARTY WILL TRY TO GET OUT OF DEAL ONE WAY OR ANOTHER

E. NO FORM AGREEMENTS FOR MANY BUSINESS ARRANGEMENTS SUCH AS
   1. LICENSE AGREEMENTS
   2. JOINT VENTURES

F. TWO UNUSUAL BUSINESS ARRANGEMENTS DESIGNED TO SATISFY NEEDS OF BOTH SIDES

ONE

I. COMPANY (ITEK) LOOKED FOR NEW PRODUCT OPPORTUNITY

II. ITEK'S GRAPHICS STRATEGY
- A. PRESENT BUSINESS
  - 1. CUSTOMERS
    - A. INPLANT PUBLISHING
    - B. SMALL PRINTERS
      - 1. NEWLY ISSUED U.S. PATENTS PRINTED ON ITEK EQUIPMENT
- B. FUTURE BUSINESS
  - 1. PHOTOTYPESETTING
    - A. SALES TO SAME CUSTOMERS
    - B. COULD BE MARKETED THROUGH SAME ORGANIZATION

III. HOW TO GET INTO PHOTYPESETTING BUSINESS
- A. TALKED TO PHOTOTYPESETTING COMPANIES ABOUT ITEK DISTRIBUTING THEIR PRODUCTS. NO INTEREST.
- B. IN DISCUSSIONS WITH OTHERS, HEARD OF TWO ENGINEERS WHO MIGHT BE INTERESTED IN DEVELOPING A PHOTOTYPESETTER FOR ITEK
- C. CONTACTED ENGINEERS WHO LEFT THEIR EMPLOYER, SET UP A SMALL COMPANY (D COMPANY) AND OBTAINED A RELEASE FROM THEIR EMPLOYER

IV. WHY DIDN'T ITEK HIRE THE ENGINEERS?
- A. ENGINEERS WANTED TO BE INDEPENDENT AND NOT BE EMPLOYEES
- B. ALSO THEY WERE PREPARED TO TAKE A RISK IF THERE WAS A POTENTIAL PAYOFF AVAILABLE
- C. ITEK DIVISION COULD NOT HAVE GOTTEN PERMISSION TO SET UP A R&D GROUP TO DEVELOP SUCH A NEW PRODUCT
- D. ARRANGEMENT ADOPTED APPEARED TO BE ABLE TO PROVIDE A REAL PRODUCT FASTER AND CHEAPER THAN IF ITEK DOING IT ITSELF

V. BUSINESS ARRANGEMENT

A. FOUR PHASE DEVELOPMENT AGREEMENT

1. DEVELOPMENT ITEMS SPECIFIED IN AGREEMENT

A. LENGTH OF PHASES

B. GENERAL GOALS OF PHASES

1. SPECIFIC GOALS TO BE NEGOTIATED AT START OF EACH PHASE

C. FINAL SPECIFICATIONS OF PRODUCT TO BE DEVELOPED

D. MONEY TO BE SPENT IN EACH PHASE

E. MONEY PAID MONTHLY AGAINST INVOICED SPECIFIED EXPENSES + OVERHEAD + SMALL PROFIT

F. MONEY OVERRUNS AND UNDERRUNS COULD BE CHARGED AGAINST OR CREDITED TOWARD OTHER PHASES, IF POSSIBLE

G. PERSONNEL SPECIFICATIONS

1. WORK UNDER AGREEMENT TO BE UNDER FULL TIME DIRECTION OF G WHO SHALL ACT AS GENERAL MANAGER OF PROJECT

2. SHALL HIRE A PART-TIME ADMINISTRATOR ACCEPTABLE TO ITEK TO MAINTAIN BOOKS AND RECORDS

2. TERMINATION

A. COULD BE TERMINATED BY ITEK ON 45 DAYS NOTICE

B. RIGHTS OF PARTIES UPON TERMINATION WERE SET FORTH

I. INCLUDING, IF ITEK DECIDED NOT TO PROCEED WITH DEVELOPMENT OF SYSTEM, ITEK WILL BE REIMBURSED IN AN AMOUNT EQUAL TO 200% OF ALL PAYMENTS MADE BY ITEK TO D COMPANY

A. AT A ROYALTY RATE OF 1% OF NET SALES ON SALES MADE BY D COMPANY

B. AT A RATE OF 25% OF WHAT D COMPANY RECEIVES FROM OTHERS IF D LICENSES OR SELLS RIGHTS IN SYSTEMS TO OTHERS

3. PATENT CLAUSES
   A. ITEK OWNED ALL INVENTIONS MADE
   B. ITEK MAKES ALL DECISIONS RE PATENT FILING AND PROSECUTION AT ITEK'S EXPENSE (10 ISSUED U.S. PATENTS AND 1 APPLICATION ALLOWED)
   C. IF ITEK DOESN'T FILE U.S. OR FOREIGN PATENT APPLICATION, D COMPANY CAN DO SO, AT D'S EXPENSE WITH ITEK GETTING NON-EXCLUSIVE LICENSE
4. ROYALTY CLAUSES
   A. D COMPANY GETS ROYALTIES ON SALES OF FIRST 10,000 (SYSTEMS SELL FOR 10-15K) SYSTEMS WHETHER OR NOT ANY PATENTS EVER ISSUE
   B. ROYALTIES ARE PERCENTAGE OF NET SALES STARTING VERY LOW AND RISING AS MORE SYSTEMS ARE SOLD
      I. ROYALTIES ARE STRUCTURED SO THAT WHEN ITEK HAS SOLD 10,000 SYSTEMS, EACH OF THE TWO ENGINEERS WILL HAVE RECEIVED 1 MILLION DOLLARS
   C. IF
      I. OTHER NON-SYSTEM PRODUCTS SOLD BY ITEK OR
      II. SYSTEM PRODUCTS ARE SOLD AFTER THE FIRST 10,000 SYSTEMS

      AND ARE COVERED BY THE CLAIMS OF AN ISSUED, AND NOT INVALIDATED U.S. PATENT OBTAINED BY ITEK UNDER THIS AGREEMENT, ITEK AGREES TO PAY A ROYALTY AT REASONABLE RATE
         I. ROYALTY BETWEEN 1 AND 5%
         II. IF CAN'T AGREE, ROYALTY WILL BE DETERMINED BY THREE-PERSON LES PANEL

D. ROYALTY PERIOD UNDER C. ABOVE
  I. STARTS UPON THE LATER OF
    A. ISSUE DATE OF U.S. PATENT INVOLVED OR
    B. DATE OF FIRST COMMERCIAL SALE OF EQUIPMENT INVOLVED
  II. ENDS ON THE EARLIER OF
    A. TEN YEARS FROM START OF ROYALTY PERIOD OR
    B. FIFTEEN YEARS FROM DATE OF AGREEMENT

E. ROYALTY PAYMENTS TO OTHERS
  I. IF ITEK MAKES ANY ROYALTY PAYMENT TO OTHERS BECAUSE OF INFRINGEMENT BY THE SYSTEM OF PATENTS OF OTHERS, ITEK MAY DEDUCT 50% OF PAYMENTS TO OTHERS AND 50% OF ITEK'S OUT-OF-POCKET COSTS RELATING THERETO
  II. D COMPANY HAS RIGHT TO PARTICIPATE IN SUCH NEGOTIATION OR LITIGATION, BUT ITEK HAS RIGHT TO MAKE FINAL DECISION.

TWO

I. COMPANY (ITEK) HAD FRAGMENTARY, UNPROVED TECHNICAL CONCEPT FOR NEW PRODUCT IN MARKET IN WHICH IT HAD NO CAPABILITY

II. CONCEPT: MAKE A CUSTOM HIGH QUALITY "PAINT-BY-NUMBER" KIT FROM ORIGINAL PHOTOGRAPH USING SOPHISTICATED ELECTRO-OPTICAL AND COMPUTER TECHNOLOGY

III. ITEK POSITION
  A. CONCEPT DEVELOPED BY DIVISION WHICH DID ONLY HIGH COST GOVERNMENT R&D CONTRACT BUSINESS
  B. 1. DIVISION HAD NO TRADITION OF INVESTING MONEY TO DEVELOP PRODUCT
    2. NO NON-GOVERNMENT MARKETING ABILITY
    3. NO EXPERIENCE IN COMMERCIAL MANUFACTURING

IV. ITEK NEEDS
  A. DON'T SPEND MONEY TO DEVELOP PRODUCT
  B. FIND SOMEONE TO MAKE AND MARKET PRODUCT

V. CRAFTSMASTER POSITION
   A. LARGEST "PAINT-BY-NUMBER" KIT MANUFACTURER IN U.S.
   B. NO TECHNICAL ABILITY TO DEVELOP PRODUCT
   C. HAD MANUFACTURING ABILITY TO MAKE "PAINT-BY-NUMBER" KIT IF EQUIPMENT TO MAKE KIT WAS DEVELOPED FOR THEM
   D. HAD MADE MARKET TEST OF HANDMADE KIT WHICH INDICATED GOOD MARKET AVAILABLE, BUT HAD NO PRODUCT

VI. BUSINESS ARRANGEMENT TO SOLVE NEEDS OF BOTH PARTIES
   A. CRAFTMASTER AGREED:
      1. PAY FOR FIXED-PRICE CONCEPT FEASIBILITY STUDY
      2. IF WANTED FURTHER TECHNICAL STUDY, ADDITIONAL COST WOULD BE DEDUCTED FROM FUTURE ROYALTIES
      3. IF CRAFTMASTER THEN GRANTED CONTRACT TO ANYONE, INCLUDING ITEK, OR DECIDED TO DEVELOP PRODUCT ITSELF, TO DEVELOP EQUIPMENT:
         A. ITEK WOULD GET INITIAL LICENSE PAYMENT
         B. WOULD GET ROYALTIES BASED ON PERCENTAGE OF "PAINT-BY-NUMBER" KIT SALES MADE BY DEVELOPED EQUIPMENT FOR FIXED PERIOD
         C. IF ITEK OBTAINED US PATENT ON EQUIPMENT OR METHOD OF MAKING "PAINT-BY-NUMBER" CANVAS USING EQUIPMENT, CRAFTMASTER WOULD PAY ROYALTY TILL EXPIRATION OF PATENT
   B. ITEK AGREED:
      1. PERFORM FIXED-PRICE FEASIBILITY STUDY AND ADDITIONAL FEASIBILITY STUDY IF NECESSARY
      2. FILE PATENT APPLICATION IN U.S. AND CERTAIN FOREIGN COUNTRIES
      3. GRANT CRAFTMASTER AN EXCLUSIVE LICENSE IN "PAINT-BY-NUMBER" FIELD

VII. RESULT
   A. FIRST TECHNICAL FEASIBILITY STUDY WAS POSITIVE
   B. ADDITIONAL TECHNICAL FEASIBILITY STUDY DEMONSTRATED FEASIBILITY

C. CRAFTMASTER GRANTED EQUIPMENT DEVELOPMENT CONTRACT TO ITEK
D. EQUIPMENT WAS DEVELOPED AND INSTALLED AT CRAFTMASTER
E. EQUIPMENT OPERATED SATISFACTORILY
F. ITEK OBTAINED U.S. AND FOREIGN PATENTS

CONCLUSION:
IF BOTH SIDES ARE FLEXIBLE AND CREATIVE, BUSINESS ARRANGEMENTS SERVING THE NEEDS OF BOTH PARTIES CAN BE OBTAINED. LAWYERS MUST TAKE THE LEAD IN SUGGESTING SUITABLE ALTERNATIVES TO BUSINESS PEOPLE.

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