

EXHIBIT J

INTELLECTUAL PROPERTY

VALUATION,
EXPLOITATION,
AND
INFRINGEMENT
DAMAGES

Gordon V. Smith

Russell L. Parr

Clarke
Exhibit 3205
Holly Thuman, CSR

LICENSING NEGOTIATIONS AND AGREEMENTS

27.1 LICENSING NEGOTIATIONS

Very often the first contact with a potential licensee is sparked when a patent owner discovers that someone is practicing its patent without a license. The word “infringement” is not usually introduced at this stage of thinking or negotiation but is lurking close. This stage of the process could be described as discovering a company that is *in need* of a license.

(a) **GETTING THEIR ATTENTION.** The first step is to send potential licensees a letter raising the issue and stating that you believe they are using your patent and should take a license. The second and third steps usually involve sending follow-up letters restating your opinion. Months typically pass before a face-to-face meeting can be arranged. You must understand, the first reaction of unlicensed practitioners is denial. The second reaction is denial, and the third reaction is a strong reluctance to pay anyone any amount of money, coupled with more denial. Your first letter probably was set aside, waiting to be joined by additional letters. The first meeting is arranged only after a series of follow-up letters and an assertive telephone call. Admittedly, just getting the attention of the unlicensed practitioner can be a difficult part of the process. Once you have made contact with potential licensees and have their attention, they are annoyed and only listening halfheartedly, but at least you have their attention. A meeting is then arranged, and the most important presentation in the entire process is scheduled.

(b) **COMPREHENSIVE PRESENTATION.** A serious, well-prepared presentation is required—mandatory. Unlicensed practitioners will be using the meeting to measure your combative worthiness. They will be listening to you, and they will be looking for weaknesses in your story. Do not approach the first meeting as an easy chat over coffee. You want money from people, and they are going to want to know why they should even consider giving you any. Potential infringers most likely have developed a product or process independently through significant efforts in research, engineering, production design, and marketing. This does not mean that you are not entitled to receive a royalty for your patent, it means that potential licensees may see you as an interloper trying to weasel in on the good fortune they are enjoying from their hard work.

At least two and possibly three people from the patent owners’ side should attend the meeting. The team members should include inside counsel and perhaps outside counsel. Engineering expertise should be presented, and someone from the business side, a decision maker, should be in attendance. The number of members on your team shows how serious you are. It also provides communications benefits. It takes at least two sets of

can find itself with a license to a company that is underperforming its obligations. Yet termination of the license because of the bankruptcy may be difficult.

Failure to make payments clauses can be used to terminate the license. In the event that the licensee does not make timely payments of royalties, the licensor should retain the right to terminate the agreement.

27.3 CRITICAL QUESTIONS

As you consider licensing negotiations, consider these big questions. They may seem like basic questions, but they are at the heart of technology transfers. These questions provide a stream-of-consciousness look into the questions that surround the pricing of technology transfers. First we consider questions from the point of view of licensing technology into a company. Then we frame the questions from the point of view of licensing technology out of a company. Many of the questions reflect considerations that occur when infringement litigation is looming in the background. Such a threat is not always involved in licensing, but the threat is common, and such a framework for these questions must be included. Specific answers for each question could not be provided because such answers are highly dependent on many factors, such as technology, products, industry, competitors, and market share of the licensor and licensee. Still, we have tried to provide some general guidance as to where an answer for each question may lie.

27.4 LICENSING-IN TECHNOLOGY

Do we really need this patent or, dare I say it, should we infringe?

Technical and legal opinions from inside and outside your organization may be needed to answer this question. Be careful; if infringement litigation ultimately is filed, these opinions may become the subject of discovery.

How many other patent licenses are we going to need?

Many industries are experiencing an avalanche of new inventions, and those in the field often find themselves facing demands from new parties, some of which they never heard of. A patent search is the place to start answering this question, but in the face of fast-moving technology fields, you may never be sure.

How much would it cost to invent around this patent?

The engineering department is the starting point for answering this question, but whatever solution it develops must pass through the patent legal office to determine if the new design actually circumvents infringement. Also, consider how long you will be out of the market while designing around the patent(s) at issue.

How long would it take to invent around this technology?

In addition to engineering costs, remember that manufacturing costs may be involved, and in some cases the change will require new marketing materials and training for the sales staff. In some cases, the amount of time may involve years.

Can we really invent around this patent, or is that guy Poindexter from R&D just a bunch of big talk?

Engineers are often overly optimistic. Such optimism makes them great inventors, but sometimes it can be harmful if negotiations are terminated too quickly.

Do they offer any technology besides the patent license?

You may discover just by asking that the licensor will provide technological know-how, future improvement patents, and consulting along with the patent license.

How long until my negotiating counterpart retires?

Is your counterpart in the negotiation a young pup trying to make a big splash within the company or an old dog waiting to join the Senior PGA Tour? Psychology and emotions play a bigger part in licensing negotiations than you might think. Spend some time learning about the personal forces driving your negotiation counterpart.

For that matter, how long until I retire?

If less than one year, take a long lunch and have a drink—stop worrying about this licensing deal. Not always, but sometimes, the questions are easy to answer.

Can I get a paid-up license for a few million dollars?

Maybe, but not likely.

I wonder if they actually would litigate.

Your legal department should be able to research how many infringement litigations the licensor has filed and the patents at issue. Such information could provide an indication of the licensor's proclivity for litigation. Find out how many of the lawsuits filed by the licensor have settled.

What would it cost to defend against an infringement lawsuit?

If the case goes all the way through trial, the legal bill could easily reach many millions of dollars. This does not include the cost of people from within your organization being diverted from their normal duties for discovery, deposition, and trial testimony.

Can I get a noninfringement opinion out of those people in our legal department?

Most often outside counsel is used for such opinions to avoid conflict of interest.

Okay, then, can I get a noninfringement opinion out of our outside counsel? What would that cost?

Getting a noninfringement opinion depends on the facts at issue. Reputable law firms usually cannot promise a favorable opinion without conducting an investigation. The cost will depend on the firm you use and the complexity of the technology and patents in the industry.

Is my adversary a major competitor?

If you are involved with licensing from a direct competitor, the royalty rate probably is going to be higher because the license grants rights for use of a market advantage. In many cases, a competitor that is licensing valuable technology to you is effectively giving you a better shot at taking some sales and the associated profits from them. The price for this right is likely to be high.

Why are all of my outside relationships adversarial?

A few studies have concluded that 85% (more in many cases) of company value is represented by intellectual property and intangible assets. You are involved with managing the most important assets that a company can hope to possess. Not only are substantial dollars at stake, but very often pride is a key issue.

In fact, why are all of my inside relationships adversarial?

This could be a different problem. Try a breath mint.

Can I get an exclusive deal and do I really need it?

You might get an exclusive deal but probably not from a competitor. In general, be prepared to pay more for exclusivity and make sure you really need it.

Is exclusivity worth paying for?

This is partly a marketing question. The sales staff may be able to tell you the importance of having an exclusive advantage for your industry. In some cases, exclusivity may be very powerful. In other cases, the power of your other intangible assets, such as trademarks and distribution networks, can make exclusivity unnecessary.

What is this product line worth to my company?

This strategic planning question deserves to be answered by a net present value financial analysis. You may find that the product in question is a fundamental component to the corporate strategy and that licensing the patent being offered is something that must be addressed.

What are my profit margins on the subject product?

Your finance department should have gross profit information, but get it to estimate selling, general, and administrative expenses so that you can negotiate from the point of view of operating profits.

What are my profits after I pay a reasonable royalty rate?

Find this amount by making sure the product still provides an appropriate investment rate of return after you pay the royalty. This book describes many methods for satisfying this requirement.

What are my profits after I pay the royalty that they are asking?

Probably very poor. Your negotiating counterpart is not likely to start out by offering a low royalty. He or she also might not have any idea about the profit margins derived from the product line by you or, for that matter, might not even understand the profit margins that the company is making. Introduction of the typical profit margins earned on products using the technology in question can show that the requested royalty rate is absurd.

How much would it take to commercialize this great idea?

For a new product this could include the time and expenses associated with engineering, manufacturing production procedures, regulatory approvals, consumer research, public relations, development of marketing programs, development of advertising campaigns, and sales training. All of these costs, balanced against the risk of product failure, must be factored into the royalty rate negotiation.

How long until we can hit the market, and what amount of capital investment is needed?

In answering this question, the time value of money becomes a central issue, and this affects the royalty rate negotiation range. A long time frame makes the present value of the project lower. This also impacts the level of royalty that can be paid.

What is my company bringing to the table in the way of trademarks, customer lists, and other intangible assets?

Your financial analysis should reflect the benefits of these valuable assets. Make sure the royalty rate does not reflect the contribution of these assets and only compensates the licensor for the patented technology that you are licensing.

Will this patented product generate sales for other products that I already sell?

Make sure this is a real possibility before agreeing to a royalty rate that anticipates such a possibility. The marketing and sales department, including salespeople in the field, should be consulted.

How much can we make in servicing contracts?

If this is a significant portion of your business, then high profits are likely. You can expect the licensor to want royalties on these service activities when you get to the next question.

Do they expect royalties on service fees?

Paying royalties on replacement parts and product refurbishment might be reasonable, and cases exist where royalties are paid on maintenance and repair services.

I wonder if they know what I am paying for other patent licenses.

They will have this information only if it is part of a past filing with the Securities and Exchange Commission (SEC) for publicly owned companies, or if your public relations department has announced past deals and details of the financial terms.

What are the other licensees of this patent paying?

Finding out might not be possible if the licensor keeps license agreements confidential and has not disclosed any financial terms in filings with the SEC.

I wish that our industry had a useful rule of thumb.

*Why? It probably would not address the specifics of your situation. Such a rule of thumb might be useful for setting an order-of-magnitude royalty, **but a customized analysis that addresses the situation at hand is preferable.** Rules of thumb can be useful for patents that define a product but not so for incremental improvements.*

How long does this patent have left to run?

This is important only if you can live without the product until the patent expires. If you cannot tolerate being out of the market that long, then the question becomes less important.

Should I pay whatever they want and then begin inventing the next-generation product?

The next generation could be a bargaining tool for lowering your royalty rate in the future. Try not to give it away in the first license agreement, though.

Suppose that we actually have been infringing. What have we really gotten out of it?

Your profit analysis may provide a hint about the answer to this question. Also take a look at your market share and trends.

Does this patent involve the whole product or just a neat little feature?

Perhaps you can limit the royalty base to only a percentage of the entire product. While this is a nice approach, it will likely be difficult to implement.

Does the market really care about the patented feature?

Assumptions here could be misleading. Ask the marketing department and talk directly to some of the sales staff who are out in the field. You may find that a particular feature is not contributing to closing sales.

Is my adversary infringing anything that we own?

This question and the next two are looking for a way to obtain a license without having to pay any cash. If you are going to cross-license, make sure that you can live with a competitor in possession of the cross-licensed technology.

What can I offer as a cross-license?

The possibilities are limited only by the patent portfolio that you possess. Finally, the reason for maintaining all of those unused patents becomes crystal clear.

What or who can my company purchase that would then let me offer a cross-license?

Licensing disputes have been solved by acquisition of a company that owns technology that your licensing counterpart needs or desires. In fact, another way to solve your problem is to acquire the licensor. Then fire your counterpart.

Does the patented product require changes to our marketing efforts?

New products can require a significant investment in marketing, distribution, and sales force training. Make sure that any royalties agree to reflect this required investment. It is a net present value kind of thing.

Will we need a new sales force, or can our current sales reps handle this new product?

The existing sales force may be able to handle another specialized product, but a dedicated sales force that handles only the new product may greatly enhance the success of your new product.

Can our current products coexist with this new one?

Product cannibalization must be considered when sales of other products for which no royalty is required might be lost to a new product requiring a royalty payment.

I wonder what royalty rates might be appropriate for my situation.

ipresearch.com offers a series of books:

- *Royalty Rates for Technology*, third edition
- *Royalty Rates for Pharmaceuticals & Biotechnology*, fourth edition
- *Royalty Rates for Trademarks & Copyrights*, third edition

Other sources of royalty rate consulting services include:

- *Royalty Source*, which can be accessed at royaltysource.com
- *Conсор, Inc.*, a consulting company located in La Jolla, California
- *InteCap, LLP*, a consulting firm headquartered in Chicago, Illinois
- *The Big Four accounting firms* often maintain a database of royalty rate information

27.5 LICENSING-OUT TECHNOLOGY

This section of the chapter looks at licensing from the point of view of trying to place the technology with another company.

Do they really need this patent? Are they infringing?

Technical and legal opinions from inside and outside your organization may be needed to answer this question. Be careful—if infringement litigation ultimately is filed, these opinions may become the subject of discovery. *Such an opinion can be a helpful negotiation tool (i.e., threat).*

How many other patent licenses are they going to need? How many others are going to hit on them?

Many industries are experiencing an avalanche of new inventions, and those in the field often find themselves facing demands from new parties, some of which they never heard of. A patent search is the place to start answering this question, but in the face of fast-moving technology fields, you may never be sure. Although it would be nice to consider this factor “their problem,” it is a reality that must be addressed. You might consider allowing them a reduction in the royalty rate if others come to them for licenses, but set a floor below which your royalty rate will not drop. Then hope that no one else comes after them.

How much would it cost to invent around our patent?

The engineering department is the starting point for answering this question, but whatever solution it develops must pass through the patent legal office to determine if the new design actually circumvents infringement. *In negotiations, your stance should be that inventing around is not a reality for them.*

How long would it take them to invent around our patent?

In addition to engineering costs, remember that manufacturing costs may be involved, and in some cases the change will require new marketing materials and training for the sales staff. *In some cases, the amount of time may involve years. Tell them they are looking at being out of the market for decades.*

Can they really invent around this patent?

Engineers are often overly optimistic. Such optimism makes them great inventors, but it can be harmful if negotiations are terminated too quickly.

Do they offer any technology we could use?

You may discover just by asking that the potential licensee has technological know-how, future improvement patents, and consulting capabilities that could benefit your company. Even if other areas of unrelated technology are involved, a cross-license might be just as good as money.

What is really driving this negotiation for my counterpart?

Does my counterpart need a “win” to build a career or to make a point in his or her organization? Does he or she really want to make a deal or just try to find out more about my organization? Emotions can play a big part in any negotiations, and examining the situation for hidden agendas can be worthwhile.

What are my real motivations?

Am I bringing some mental baggage to the negotiation that may be getting in the way? Is there undue pressure to “make a deal, any deal”? Am I focused only on the business aspects of the negotiation?

Should I consider offering a paid-up license for a few million dollars?

Only if your patent is fraught with weaknesses that will not stand the test of a trial.

I wonder if they actually would litigate.

Your legal department should be able to research the number of infringement litigations involving the licensee and the patents at issue. Such information could provide an indication of the licensee's proclivity for litigation. Find out how many of the lawsuits have settled.

What would it cost to bring an infringement lawsuit?

If the case goes all the way through trial, the legal bill could easily reach millions of dollars. This does not include the cost of people from within your organization being diverted from their normal duties for discovery, deposition, and trial testimony.

Can I get an infringement opinion out of those ultraconservatives in our legal department?

Most often outside counsel is used for such opinions to avoid conflict of interest.

Okay, then, can I get an infringement opinion out of our outside counsel? What would that cost?

Getting an infringement opinion depends on the facts at issue. Reputable law firms usually cannot promise a favorable opinion without conducting an investigation. The cost will depend on the firm you use and the complexity of the technology and patents in the industry.

Is my adversary a major competitor?

If you're involved with licensing to a direct competitor, the royalty rate probably is going to be higher because the license grants rights for use of a market advantage. In many cases, a competitor that is licensing valuable technology from you is effectively taking some of your sales and the associated profit. Remember that letting the competitor have incremental sales might be reasonable if it keeps you from having to invest in added manufacturing capacity and supporting infrastructure. If you have enough excess capacity, then giving away incremental sales is expensive and the royalty rate should reflect that fact.

Why are all of my outside relationships adversarial?

A few studies have concluded that 85% (more in many cases) of company value is represented by intellectual property and intangible assets. You are involved with managing the most important assets that a company can hope to possess. Not only are substantial dollars at stake, but very often pride is a key issue.

Should I give them an exclusive deal, and how much more royalty can I really get out of them for it?

If you are in the market, then you do not want to give them an exclusive deal. You will want to practice the invention for yourself and may be able to get a percentage of sales from all of the other competitors in the industry. Unless the potential licensee is willing to make good for the royalties that all of the other industry players might generate, then an exclusive deal is probably not the way to go.

Will they think that exclusivity is worth paying for?

This is partly a marketing question. The sales staff may be able to tell you the importance of having an exclusive advantage for your industry. In some cases, exclusivity may be very powerful. In other cases, the power of their other intangible assets, such as trademarks and distribution networks, can make exclusivity unnecessary.

What is this product line worth to their company?

This strategic planning question deserves to be answered by a net present value financial analysis. You may find that the product in question is a fundamental component to the corporate strategy and that licensing the patent being offered is something that must be addressed.

What are their profit margins on the subject product?

If you are not in the industry, it may be hard to determine their profit margin. Outside consultants and other industry research may be needed. If you are a market participant, then your finance department can use your profit margins as a proxy for their margins.

What are their profits after they pay a reasonable royalty rate?

Find this amount by making sure the product still provides an appropriate investment rate of return after they pay the royalty. This book describes many methods for satisfying this requirement.

What are their profits after they pay the royalty that they want to pay?

Probably terrific. Your negotiating counterpart is not likely to start out by offering a high royalty. He or she also might not have any idea about the profit margins the company is earning from the product line. It is not all that uncommon. Introduction of the typical profit margins earned on products using the technology in question can show that the requested royalty rate is quite reasonable.

How much would it take to commercialize this great idea?

For a new product, this could include the time and expenses associated with engineering, manufacturing production procedures, regulatory approvals, consumer research, public relations, development of marketing programs, development of advertising campaigns, and sales training. All of these costs, balanced against the risk of product failure, must be factored into the royalty rate negotiation. You have to let them earn a profit on their investment and a reward for bearing risk.

How long until they can hit the market, and what amount of capital investment is needed?

In answering this question, the time value of money becomes a central issue, and this affects the royalty rate negotiation range. A long time frame makes the present value of the project lower. This also impacts the level of royalty that can be paid.

What is their company bringing to the table in the way of trademarks, customer lists, and other intangible assets?

Your financial analysis should reflect the benefits of these valuable assets. Make sure the royalty rate does not reflect the contribution of these assets and only compensates you for the patented technology that you are licensing. If you can get away with a royalty that represents more than the patented invention, you may be happy for a while, but in the long run conflict will result.

Will this patented product generate sales for other products that they already sell?

The marketing and sales department, including salespeople in the field, should be consulted.

How much can they make in servicing contracts?

If this is a significant portion of their business, then high profits are likely. You can expect the licensee not to want to pay royalties on these service activities, but if your

patented invention provides this type of opportunity, then getting royalties on all the benefits the licensee will enjoy is reasonable.

Can we get royalties on service fees?

Paying royalties on replacement parts and product refurbishment might be reasonable, and cases exist where royalties are paid on maintenance and repair services.

I wonder if they know what I am willing to accept from other licensees.

They will have this information only if it is part of a past filing with the SEC for publicly owned companies, or if your public relations department has announced past deals and details of the financial terms.

I wish that our industry had a useful rule of thumb.

*Why? It probably would not address the specifics of your situation. Such a rule of thumb might be useful for setting an order-of-magnitude royalty, but a **customized analysis that addresses the situation at hand is preferable**. Rules of thumb can be useful for patents that define a product but not so for incremental improvements.*

How long does this patent have left to run?

This is important only if they can live without the product until the patent expires. If they cannot tolerate being out of the market that long, then the question becomes less important.

Should I promise them access to the next-generation product?

The next generation could be a bargaining tool for raising your royalty rate. Try not to give it away in the first license negotiation session.

Suppose that they actually have been infringing—what have they really gotten out of it?

Their profit analysis may provide a hint about the answer to this question. Also take a look at their market share and trends.

Does this patent involve the whole product or just a neat little feature?

Tell them it does not matter. Your patent is in their product, and the price of the entire product is the royalty base.

Does the market really care about the patented feature?

Assumptions here could be misleading. Ask the marketing department, and talk directly to some of the sales staff who are out in the field. You may find that a particular feature is not contributing to closing sales.

Are we possibly infringing anything that they own?

If so, this license might get you out of the box by negotiating a cross-license.

What can they offer as a cross-license?

The possibilities are limited only by the extent of their patent portfolio. Be careful that they offer you meaningful technology in the cross-license. They may offer a lot of technology from which you may never gain any benefit.

Does the patented product require changes to their marketing efforts?

New products can require a significant investment in marketing, distribution, and sales force training. Make sure that any royalties agreed to reflect this required investment. It's a net present value kind of thing.

Will they need a new sales force or can their current sales reps handle this new product?

Their existing sales force may be able to handle another specialized product, but a dedicated sales force that handles only the new product can greatly enhance the success of the new product. Take the position that they will be able to gain new sales from their existing sales force.

Can their current products coexist with this new one?

Product cannibalization must be considered when sales of other products for which no royalty is required might be lost to a new product requiring a royalty payment. Once again, your position should start with a picture of perfect coexistence. It may be helpful, though, to have a firm grasp on reality.

27.6 CONCLUSION

Each party in a negotiation must face the same questions. A fair result will occur when each party reaches the same answers. Good luck.