

Licensing

- ▶ Licensing involves obtaining permission from a company (licensor) to manufacture and sell one or more of its products within a defined market area. The company that obtains these rights (the licensee) usually agrees to pay a royalty fee to the original owner



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Why would a company look for products it can produce under license?

- ▶ In today's world of rapid technological change, new technologies are the key to economic growth. Today, many products have very short life cycles and are readily replaced in the marketplace by new technology. If a company wants to survive, it needs to continually add new products to replace declining products.
- ▶ Also, a company may want to grow and diversify by expanding its product line to take up excess manufacturing or marketing capacity, level out seasonal highs and lows, or simply add to profitability with a proven product. Companies may not have the internal skills, time, or money to develop their own new products, so obtaining a proven product quickly through licensing may be very attractive.



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What are the advantages of licensing?

- ▶ You get access to the experience and know-how of the company that developed the product. This company may be much larger than yours, with development capabilities that you cannot afford.
- ▶ You get to break into a new market with this new product, but with the benefit of the experience gained in another market.
- ▶ It makes competition easier if you're a small company with limited resources.



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What are the advantages of licensing?

- ▶ You minimize your costs and risks:
 - it costs less than buying an entire company;
 - you don't pay for expensive and time consuming research and development;
 - you don't pay development costs up front; you pay royalties when you start making sales; and
 - you won't have large losses if the product doesn't become successful in your market area.



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What are the disadvantages of licensing?

- ▶ The license agreement is normally for a considerable period of time and there may be an annual minimum royalty required.
- ▶ New technology may become available making the licensed opportunity obsolete.
- ▶ The agreement may force the licensee to accept restrictions on its marketing.
- ▶ The licensee may lose the capacity to develop its own technology internally.



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What does a typical licensing agreement cover?

- ▶ Subject Matter of the Agreement—may be (1) patent, (2) copyright, (3) trademark, (4) industrial design, (5) trade secret (know-how, technology, experience, etc.)
- ▶ Granting of Rights—defines what licensor is transferring to licensee
- ▶ Licensor's Obligation—sets out how transfer is to take place in terms of assistance, support, training and co-operation



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What does a typical licensing agreement cover?

- ▶ Licensee's Obligation—sets out financial requirements, guarantees of licensee, secrecy, costs, etc.
- ▶ License Fee—fee paid to licensor on signing agreement
- ▶ Royalty—ongoing share of proceeds paid to licensor for the rights. May be a lump sum, or percentage of proceeds or amount per unit sold, etc., usually a minimum royalty is required.



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What does a typical licensing agreement cover?

- ▶ Term—how long the agreement is to last
- ▶ Designated Area and Exclusivity—define manufacturing and marketing area of license
- ▶ Termination—describes rights of both licensor and licensee to terminate agreement
- ▶ Guarantees—licensor will normally not guarantee the results of using the rights granted. The licensee may be required to provide warranties, public liabilities, etc.



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How does a company search and find products that may be available for licensing?

- ▶ Steps to take:
 - Prepare a profile of your company
 - Search sources
 - Determine feasibility of opportunities found
 - Negotiating a license agreement



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Prepare a profile of your company

- ▶ name of contact person and title;
- ▶ reason (i.e. diversification, complement present products, efficiency);
- ▶ facilities for manufacturing/marketing;
- ▶ present products/services;
- ▶ marketing area presently serviced;
- ▶ sales volume;
- ▶ description of search requirements (i.e. product/process, etc.);
- ▶ markets desired for licensed opportunity with special note if different from markets normally being serviced; and
- ▶ exclusivity, protection requirements desired.



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Search sources

- ▶ There are a large number of sources that may be used in searching for products/processes, etc., under license that can be contacted:
 - licensing consultants with clients offering opportunities;
 - international licensing exhibitions;
 - publications offering licensing opportunities by subscription;
 - consulates in foreign countries;
 - provincial trade offices in foreign countries;
 - federal/provincial/state agencies in foreign countries;
 - trade directories of manufacturers in foreign countries;
 - Chambers of Commerce in foreign countries;
 - universities with research facilities;
 - research and development companies;
 - trade associations;
 - trade publications; and
 - import replacement.



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- ▶ Providing a profile of your company and its search requirements to any or all of the foregoing would result in you receiving names and addresses of prospective licensors for your direct contact. When contacting prospective licensors, you should enclose your company profile and request assurance that they are prepared to license.
- ▶ It would be important to ask as well if they have licensed others, and if so, request that they provide the names, addresses, etc., and permission to contact.



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Determine feasibility of opportunities found

- ▶ Licensor should provide licensee sufficient information to determine feasibility of the opportunity in the proposed area.
 - ▶ Licensor should provide: product brochure, bill of materials and specifications, labour and time, how long marketed and growth, other licensees (where located and right to contact), benefits over competition, estimated total market, warranties, marketing, training provided, financial terms, etc.
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Determine feasibility of opportunities found

- ▶ Prospective licensee does a feasibility study based on his area and the market he will have.
 - ▶ Licensor may require the potential licensee to sign a Confidential Disclosure Agreement before providing a full package of information. If negotiation is lengthy the licensor may request a letter of intent and some partial payment for keeping the opportunity available for a period of time until licensee determines feasibility.
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Negotiating a license agreement

- ▶ Usually a licensing agreement will be provided by the licensor once it has established the licensee is serious with regard to the opportunity. The terms of the agreement are negotiable. Using the information obtained from your feasibility study and considering the financial requirements of the licensing agreement, you should be positive the licensing opportunity will provide an acceptable profit and return. Minimum annual royalties should be carefully studied to ensure they can be reasonably met.
 - ▶ A license opportunity from an inventor, if one is the first licensee should be very reasonable, as the inventor is looking for credibility, which will be established by the first licensee.
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What is the procedure if you or your company has a product to license to others?

- ▶ You've invented something, it has received a positive evaluation, and has a patent pending. Or maybe your company doesn't have the capital or expertise to manufacture and market its product to a global market. Inventors often find it is better to license their technology rather than try to manufacture and market it themselves. Similarly, licensing may be the only practical way for a company to maximize the potential for its existing products.
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- ▶ Licensing companies in other areas of the country or in other countries expands your potential while minimizing your risk by using companies that have the necessary manufacturing capability and marketing networks already in place.
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- ▶ Licensing can be done by a single company, however if this is not possible, an alternative is to consider a multi-prong approach to your licensing with several component parts being done by different manufactures, final assembly by another, and possibly distribution by yet another. This may divide up the risk if the magnitude of the project is perceived too large by any one licensee.
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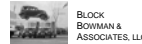


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- ▶ Licensing out of a product, process, technology, etc., will follow much the same procedures as licensing in or searching for opportunities.



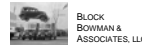
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- ▶ You will need to prepare a formal presentation to explain the functionality and marketability of the concept containing the following:
 - letter of introduction;
 - pictures of the product;
 - product description;
 - manufacturing information;
 - product variations;
 - product benefits;
 - market research results;
 - objectives for your project; and
 - pricing breakdown.



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- ▶ As a licensor, you will be expected to provide the legal agreement that will ensure both parties are fully aware of their respective rights and responsibilities, over and above simply determining royalties.



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- ▶ Good legal advice is usually required to negotiate such things as:
 - exclusive rights to the invention;
 - territories allocated;
 - what exactly is being licensed (technology transfer, engineering specs, use of trademark);
 - who pays for obtaining patents in licensed territories;
 - are future improvements to the product included under the license;
 - what resources are available if the licensee is late on payments;
 - can either party transfer rights under the agreement to another party;
 - who bears liability resulting from injuries sustained from the product; and
 - what are termination provisions of the agreement.



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- ▶ Determining an acceptable royalty rate for a product is difficult, as there is no quick-fix percentage that can be applied as a general measure. Although rates ranging from 3% to 8% of net sales are common, each licensing agreement is unique and the only consensus that matters with respect to royalty rates is the one that occurs between the licensor and the licensee as a result of negotiations



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- ▶ Several factors that may influence the potential royalty rate of a licensed product include:
 - if the product is already patented;
 - is the product "market ready"; and
 - does the licensor have a track record of successful products.

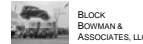


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- ▶ If you are an inventor and wish to approach a large company with your invention, you may find that they have very specific policies on how they will consider unsolicited proposals. Your first response from them will usually be to spell out the terms and conditions of their corporate policy on submissions.



A license

- ▶ A **license** is really nothing more than a contractual right that gives someone permission to engage in a defined activity or to use certain property that is owned by someone else.

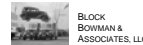


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- ▶ Licenses have taken on special significance as the **universal means to protect "proprietary" (ownership) rights** in software and other computer products. A license allows the holder of intellectual property rights (the "**licensor**") to make money from an invention or creative work by charging a user (the "**licensee**") a fee or royalty to use the licensed product.



Where Do I Start?

- ▶ There is no magic to giving someone a license to use your property. In business, a **written license agreement** is essential to enforce your rights, but it doesn't have to be long or complicated in order to be enforceable.

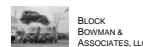


Where Do I Start?

- ▶ Before you even get to the point of negotiating a license agreement, though, it's extremely important to make sure that you first have the **exclusive rights** to that property. While the law is constantly evolving in this area, the best way to lock in exclusive rights to intellectual property is to register for any or all of the following that may apply to your situation:
 - **Copyrights** - original works of authorship fixed in any tangible medium of expression
 - **Patents** - inventions
 - **Trademarks** -- words, names or symbols that identify goods made or sold, and that distinguishes them from goods made or sold by others



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- ▶ Applying for a copyright, patent or trademark registration can involve a rigorous approval process that requires you to disclose your idea to the public at large. So you may also want to further protect your intellectual property by relying on **trade secret laws**. Generally, these laws protect internally guarded ideas, formulas, codes or other information that provides a business with a competitive advantage. Source code to software is a good example of something that would be a trade secret.



What Do I Include In a Licensing Agreement?

- ▶ You don't necessarily have to reinvent the wheel in drafting a license agreement. Although you shouldn't copy them, you can certainly **look at existing agreements** other companies have used in order to get an idea of what you need to do. One place to start looking, for example, would be license agreements used for all of the programs on your computer



- ▶ The first thing a license agreement should do is to clearly define the **scope of the license**. By licensing a product, you are **assigning a limited right to use** that property, so you must be sure to retain the ultimate ownership rights. At the same time, you don't want to be overreaching or too limiting so as to discourage potential customers from using the product.



- ▶ Except for custom-made products, a license agreement would typically be **non-exclusive**, meaning that the licensor can sell the same rights to other users. However, this wouldn't necessarily allow the licensee to reproduce or pirate the product and sell it to third parties. Sometimes, licenses allow reproduction within a controlled environment such as with **enterprise licenses** or **network licenses**. In other cases, a licensor may allow for a **resale license**, with a royalty being paid to the licensor.



- ▶ Next in importance are provisions controlling **revenue streams** generated by licensed products. With most license agreements on end user software for consumers, for example, a one-time **license fee** is usually paid when the software is purchased. Other arrangements may include recurring payments such as **royalties** or **monthly lease payments**. License agreements may also cover **maintenance charges** such as ongoing maintenance.



- ▶ Other topics to cover include:
 - Term (the length of the agreement)
 - Rights to modify and combine with other products, if any
 - Prohibited uses
 - Rights to transfer and sublicense
 - Rights to source code
 - Acceptance, testing and training procedures
 - Warranties
 - Limitations on the licensor's liability
 - Support and maintenance services
 - Nondisclosure of confidential information
 - Indemnity for infringement
 - Enforcement of remedies
 - Terminating the contract



How is a Licensing Agreement Enforced?

- ▶ In addition to protections of a license agreement, federal laws (including the **Digital Millennium Copyright Act**) provide **stiff civil and criminal penalties** for pirating and other unauthorized use of software. It may be possible, for example, for a licensor to get an injunction and monetary damages. The licensor may then receive actual damages, which includes the amount lost because of infringement, plus any profits attributable to the infringement

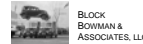


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- ▶ In addition, the government can criminally prosecute you for copyright infringement. Penalties can include up to five years in prison and a fine of up to \$500,000. Second-time offenders risk 10 years of prison and a \$1,000,000 fine.



Legal Guidance

- ▶ Many issues may come in the course of drafting a license agreement, and the laws relating to intellectual property can be extremely complicated. You should involve **legal counsel** in the drafting of a license agreement, as well as enforcing issues that may arise with agreements already in place.

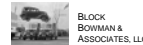


Key Elements of an Agreement

- ▶ Once you decide to enter into formal negotiations for a contract to license your technology, you'll need to be prepared to discuss the specific terms and conditions of a license agreement. These provisions vary, depending on whether the license is for merchandising an entertainment property, exploiting a given technology, or distributing a particular product to an original equipment manufacturer (OEM) or value-added reseller (VAR).



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- ▶ As a general rule, any well-drafted license agreement should address the following topics:
 - *Scope of the grant*
 - *Term and renewal*
 - *Performance standards and quotas*
 - *Payments to the licensor*
 - *Quality control, assurance and protection*
 - *Insurance and indemnification*



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- *Accounting, reports and audits*
 - *Duties to preserve and protect intellectual property*
 - *Technical assistance, training, and support Warranties*
 - *Infringements*
 - *Reports and Record Keeping*
 - *Exclusivity*
 - *Technical Support and Key Personnel*



Scope of the grant.

- ▶ The exact scope and subject matter of the license must be defined early on. Any restrictions on the geographic scope, rights of use, permissible channels of trade, sublicensing or assignability to another party, or exclusion of improvements to the technology (or expansion of the character line) should be clearly set forth in this section.



Term and renewal.

- ▶ The commencement date, duration, renewals and extensions, conditions for renewal, procedures for providing notice of intent to renew, grounds for termination, obligations upon termination and licensor's reversionary rights in the technology should all be included in this section



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Performance standards and quotas.

- ▶ To the extent that the licensor's consideration will depend on royalty income that will be calculated from the licensee's gross or net revenues, the licensor may want to impose certain minimum levels of performance in terms of sales, advertising, promotional expenditures and human resources to be devoted to the exploitation of the technology. You can expect the licensee to argue for a "best efforts" provision that is free of performance standards and quotas. In such cases, the licensor may want to insist on a minimum level of royalties that will be paid, regardless of the licensee's actual performance



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Payments to the licensor.

- ▶ Virtually every type of license agreement includes some form of initial payment and ongoing royalty to the licensor. Royalty formulas vary widely, however. They may be based on gross sales, net sales, net profits, fixed sum per product sold, or a minimum payment to be made to the licensor over a given period of time. A sliding scale may be allowed, to provide some incentive to the licensee as a reward for performance.



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Quality control, assurance and protection.

- ▶ Quality-control standards and specifications for the production, marketing, and distribution of the products and services covered by the license must be set forth by the licensor. In addition, procedures that allow the licensor an opportunity to enforce those standards and specifications should be included in the agreement. That might mean the right to inspect the licensee's premises, review, approve, or reject samples produced by the licensee, or review and approve any packaging, labeling, or advertising materials to be used in connection with the exploitation of the products and services that come within the scope of the license.



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Insurance and indemnification.

- ▶ The licensor should take all necessary and reasonable steps to make sure the licensee has an obligation to protect and indemnify the licensor against any claims or liabilities resulting from the licensee's exploitation of the products and services covered by the license.



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Accounting, reports and audits.

- ▶ The licensor must impose certain reporting and record-keeping procedures on the licensee, in order to ensure an accurate accounting for periodic royalty payments. The licensor should also reserve the right to audit the licensee's records in the event of a dispute or discrepancy, along with provisions as to who will be responsible for the cost of the audit in the event of an understatement.



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Duties to preserve and protect intellectual property.

- ▶ Define carefully the obligations of the licensee, its agents, and employees to preserve and protect the confidential nature of the technology and to acknowledge its ownership. This section also describes any required notices or legends that must be included on products or materials distributed in connection with the license agreement (for example, stating the nature of the relationship between licensee and licensor or identifying the actual owner of the intellectual property).



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Technical assistance, training, and support.

- ▶ This section of the agreement describes any obligation of the licensor to assist the licensee in the development or exploitation of the technology being licensed. The assistance may take the form of personal services or documents and records. Either way, any fees due to the licensor for such support services, over and above the initial license and ongoing royalty fee, must also be specified.



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Warranties.

- ▶ A prospective licensee may demand that the licensor provide certain representations and warranties in the license agreement. These may relate to the ownership of the intellectual property, such as absence of any known infringements of patents or restrictions on the owner's ability to license the intellectual property, or may guarantee that the technology has the features, capabilities, and characteristics previously presented in the negotiations.



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Infringements.

- ▶ The license agreement should specify procedures for notifying the licensor of any known or suspected direct or indirect infringements of the subject matter being licensed. Responsibility for the cost of protecting and defending the technology should also be specified in this section.



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Reports and Record Keeping.

- ▶ In all licensing agreements, adequate reporting and record keeping by the licensee is critical to ensure that the licensor receives all royalty payments when they are due. Additional reports should be prepared monthly or quarterly that disclose the following:
 - licensee's actual use of the technology
 - research studies or market tests that have directly or indirectly used the technology;
 - marketing, advertising, or public relations strategies planned or implemented that involve the technology
 - progress in meeting of established performance objectives and timetables
 - threatened or actual infringement or misappropriation of the licensor's technology
 - requests for sublicenses or cross-licenses that have been made to the licensee by third parties.



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Exclusivity.

- ▶ The term exclusive in the context of a licensing agreement negotiation is often misunderstood. Exclusivity could apply to a territory, an application of the technology or a method of producing any products that result from the technology. Exclusivity may or may not pertain to the licensor itself, and may or may not permit the granting of sublicenses or cross-licenses to future third parties who are not bound by the original license agreement. It may or may not be conditioned on the licensee meeting certain predetermined performance standards. Exclusivity may be conditional, for a limited period of time, on the continued employment of certain key technical staff of the licensee.



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Technical Support and Key Personnel.

- ▶ The proper development and exploitation of the technology often depends on the availability of the proprietor and the licensor's technical team to provide support and assistance to the licensee. The conditions under which this team will be available to the licensee should be included in the technology license agreement. Provisions should be drafted to deal with scheduling conflicts, the payment of travel expenses, the impact of the inventor's disability or death, the availability of written or videotaped data in lieu of the inventor's physical attendance, the regularity and length of periodic technical-support meetings and the protection of confidential information.
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The Top 10 Most Common Intellectual Property Rights Mistakes During Venture Capital Due Diligence



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1. TOO LATE TO START FILING US AND INTERNATIONAL PATENT APPLICATIONS.

- ▶ Unfortunately for many good technology companies, it may be too late to file for patent protection. The current U.S. rule generally provides applicants with a 1-year grace period during which a patent application must be filed after certain public or private disclosure of the invention. Such disclosure may arise, for example, from a mere "offer for sale" of the technology, even if the product has not yet been built or prototyped. In comparison, the foreign rule, which applies to many industrialized jurisdictions, such as Japan and various European countries, do not give applicants the benefit of any grace period after a public disclosure has occurred. Thus, it is legally compelling for applicants to consider filing for patent protection sooner than later. Although in some situations, there may be some special exception that still allows for late filings; it is not advisable for applicants to count on those exceptions.
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2. TOO NARROW LEGAL SCOPE OF CLAIMING PATENTABLE INVENTIONS

- ▶ Many issued patents are not commercially valuable because the scope of their submitted claims are particularly narrow, and can be relatively easily avoided by determined competitors. Thus when submitting new patent claim language, applicants should broadly define novel concepts that include potential design-around by other parties. Although this legal blocking strategy sounds easy enough to state as an objective, in fact, the serious exercise of analyzing future competitive and industry directions can be an extremely difficult task, particularly because the analysis often requires sophisticated market understanding, as well as technical and engineering vision.
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3. INTERNALLY MISMANAGED PATENT INFRINGEMENT "WILFULNESS" EXPOSURE.

- ▶ Under U.S. patent law, one's awareness or willful state-of-mind about the existence and infringement of a competitor's issued patent may significantly affect subsequent legal liability. Thus if a party is proven to be a willful infringer of a known patent, then for punitive policy reasons, economic damages may be awarded to the patent owner up to three times normal recovery amount. This treble-damage exposure is so substantial, that company management should be careful to avoid creating evidence of internal communications such as emails that may be construed later to indicate such willfulness state-of-mind. Additionally in many cases, it may be appropriate for companies as a matter of policy to discourage looking at issued patents owned by other entities. And when a suspect patent is already known, management must take careful steps to refer the matter to competent patent counsel for appropriate analysis and opinion.
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4. RELYING SOLELY ON COPYRIGHTS FOR SOFTWARE PROTECTION.

- ▶ Copyright protection in the U.S. and many other countries arises instantly and at virtually no cost to protect software technologies, such as computer programs, electronic databases, and graphical display screens and related media. In fact, copyright protection is often quite a suitable means to secure much digital media such as video and audio creative works, often even without compliance with copyright registration and notice requirements. Copyright protection, however, is legally vulnerable to reverse-engineering efforts by competitors, during which no copyright infringement may arise when the reverse engineering results does not result in literal copying of the original code, but merely an understanding of the underlying ideas and functions. In this vulnerable scenario, perhaps patent protection may be more appropriate to secure any novel algorithm, methods, and computing apparatus.
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5. INADVERTANTLY TAINTING I.P.R. WITH 3RD-PARTY CO-OWNERSHIP RIGHTS.

- ▶ During the course typically of joint-development engineering projects, ideas may originate from many sources, such as advisors, consultant, employees, and even customers. This collaborative scenario sets the stage for creating intellectual property rights that may be co-owned by multiple parties. And unless the rights of such joint owners are specified up-front, for example by contract terms, then there is a problematic possibility that certain parties later may assert not just their partial ownership interest, but actually endeavor to offer licensing rights to other 3rd parties or even competitors.



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6. IGNORING THE IMPACT OF NEW "FESTO" U.S. SUPREME COURT RULING RE PATENT AMENDMENTS.

- ▶ On May 28, 2002, the U.S. Supreme Court (*Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd*) substantially changed the legal effect of amending patent claims, particularly upon the effective scope of amended claims. This judicial change cannot be ignored without possibly impairing commercial value of many issued U.S. patents, especially where applicants introduce explicit argument that distinguish various prior-art cited by the Patent Examiner. Without getting into the subtle legal and policy complexities associated with the so-called "Doctrine of Equivalents," the Festo decision and related subsequent federal cases clearly narrow many patent claims scope whenever applicants propose routine amendments to distinguish the claimed invention against cited prior-art references.



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7. UNDERESTIMATING THE IMPORTANCE OF TRADE SECRETS AND CONFIDENTIALITY.

- ▶ Since patent protection may not arise for many years until after filing patent applications, and copyright protection may not be applicable to protect functional aspects of various technologies, trade secret protection may serve realistically as a solid backstop against competitive piracy or other misappropriation of company know-how. Thus the importance of diligent use of Non-Disclosure Agreements (NDA) and in-house policies and systems to secure confidential and proprietary information rises to a more significant level of management priority. Additionally early disclosures, for example through customer marketing presentations, may irreparably hurt company rights to file domestic or international patent applications.



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8. OVERLOOKING LEGITIMATE OPPORTUNITY TO SET-UP OFFSHORE LICENSING TAX SHELTERS.

- ▶ Often neglected by early-stage startup companies and entrepreneurs are offshore strategies for mitigating federal tax exposure. Such international tax strategies are especially relevant when foreign licensees of intellectual property rights are contemplated possibly in the company business plan. In many cases in fact, it is particularly beneficial to deploy one or more corporate entities offshore much sooner, rather than after licensees are identified, in order to minimize certain taxable valuation exposure associated with transferring such licensed rights.



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9. RESPONDING SLOWLY TO U.S.P.T.O. OFFICE ACTIONS.

- ▶ Because the U.S. patent rules now provide 20 years of enforcement patent protection, after the U.S. filing date, it is important to expedite the claim amendment and application prosecution process; otherwise applicant's enforcement period is effectively eroded by unnecessary delays in the process. Accordingly, applicants should endeavor to respond in timely fashion, expediting all office action responses and facilitating communications with patent counsel whenever possible. Additionally, the new patent rules actually apply a time penalty to deduct enforcement period against issued U.S. patents in certain situations where applicants contribute to delays during patent prosecution



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10. OVER/UNDER-SPENDING ON LEGAL FEES TO PROSECUTE PATENT APPLICATIONS.

- ▶ In the realistic context of the current economic recession especially in Silicon Valley, startup companies and entrepreneurs who are strapped for cash may negotiate for substantial fee discounts from patent counsel to prepare and file patent applications. However, patent applicants should be careful to ensure that most qualified legal counsel in terms of technical and business experience are selected and engaged to work on critical company inventions, perhaps with bottom-line pricing being just one of a number of significant factors to consider



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