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This text first appeared in the *IAM* magazine supplement
'Licensing in the Boardroom 2006' August 2006
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Licensing in the Boardroom 2006

Key licensing issues for senior executives

A supplement to *Intellectual Asset Management* magazine
www.iam-magazine.com

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Value added: licensing know-how as well as IP rights

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Normally, know-how is regarded as an afterthought or an add-on in a technology licence agreement, an addition to the “real” registered rights. This is normally done in an attempt to cover any intellectual property (IP) which may have been overlooked and to extend the life of the licence potentially past the maximum life expectancy of registered IP, such as patents or designs. However, in doing so, and by not paying careful attention to the details of the know-how being licensed, licensees and licensors alike may be inadvertently prejudicing themselves.

Since all patents and designs are open to attack on the grounds of lack of novelty and/or inventiveness, it is a fact that these registered rights may be rendered invalid and unenforceable by a single piece of prior art and a particularly tenacious database searcher. However, the value residing in the know-how lives on and remains licensable. Is it not time that practitioners, licensees and licensors started realising the value represented by the “ugly sister” of IP rights?

Business model development

In order to explain the kind of value inherent in know-how, it is important to understand the phases of development of a product or service. When a new concept is first invented by that flash of creative or lateral thought, this bare concept is normally protected in its simplest conceptual form by the priority patent or design applications. At this point, the base concept and the rights to it represent potential value that may be obtained from revenue streams created in the exploitation of a product or service.

However, this potential value is offset by risk, which comes from commercial uncertainty and which reduces the real value of the concept, so that few business partners and/or licensees would be willing to

be involved in the untried, untested concept at this stage. At this point it may be worthwhile to describe loosely how new business models get developed.

Commercialisation of a product may be viewed as a cycle rather than a path. During the commercialisation cycle, three broad main phases may be seen. These are: the technical proof of concept; the commercial proof of concept; and the marketing proof of concept.

Starting at any one of these phases (normally at the technical proof of concept for a product) with a set of assumptions will allow the development of a set of answers to those assumptions. The use of those answers as a base set of assumptions in the next phase, such as the commercial proof of concept, will then provide answers to be used in the next, and so on. As an example, let's have a look at the commercialisation of a product such as a new sports car. The method of manufacture of a product (e.g. handcrafted) may influence the cost of the product, making it very expensive (above a threshold price), which would then influence the target market (e.g. multi-millionaires only), which may mean that only particularly high quality materials may then be used (e.g. carbon fibre), which then changes the design and the cost, and so on.

Development of peripheral IP

Once the questions posed (How will it work? What will it cost? Who will we sell it to?) at each of these phases has been answered and these balance the answers provided from the other phases, then the business model for this product will be clearer and the risk will be substantially reduced, creating a clearer idea of the real value of the concept.

The application of the intellect in answering the questions posed by these phases results in the creation of peripheral IP. This IP may be in the form of additional registrable IP, such as further patents

and/or designs, or may be in the form of confidential information or know-how.

The creation of this peripheral IP is what makes the difference between having rights to a base concept with only potential value and having rights to a usable, available and practical set of IP that may be readily and practically applied in order to create a revenue stream.

At this stage, there are a few ideas that bear scrutiny as regards that magic word know how. This concept can be found most readily in the technical and engineering processes related to the production of a product, in areas such as materials specifications, CAD/CAM software and software in general, manufacturing processes and tolerances and operational and training manuals, as well as customer connections. Often in licence agreement, the definition of know-how covers most of these aspects, relating to them generally and vaguely.

The value of know-how

The benefits of having properly recorded and current know-how for licensing purposes are two-fold. The first benefit of know-how is that it is that part of IP that guarantees consistent performance through consistent application of the (up-to-date and correct) know-how by employees in the production of the products or services in a business. From this perspective, it follows that it is one of the most important duties of the management of a business to introduce systems and incentives to get employees (especially key employees) to disgorge skill, understanding and talent from within themselves, and to reduce it to material form, so that it may be used by the business in the consistent creation of wealth, regardless of the comings and goings of its staff. It is also important for businesses to measure and reward the output of key personnel in the creation of such IP.

With this in mind, it is easy then to understand why know-how should be regularly and accurately documented, and why accurate record keeping should be kept as part of everyday business processes. A well-managed company, which keeps accurate records and has the systems in place to sustain the upkeep of this know-how, will then find it much easier to show potential licensees how value may be obtained by the consistent application of the know-how licensed. In fact, the real value or advantage of the know-how may be easily demonstrated since it is normally so closely

related to technical aspects of the products.

For this reason, the term know-how should be defined with reference to a particular data pack of information that may be included in the agreement, or must be handed over afterwards as part of the technology transfer mechanism. If this is not possible, both the licensee and the licensor should be seriously questioning why, since this is highlighting inefficiencies in their business systems in the case of the latter and possibly short-changing the former.

The second benefit of know-how is that proprietorship of it may be viewed as a strategic advantage in that the time taken in its development (and in the development of the peripheral IP mentioned above) serves as a time barrier to entry for competitors. Licensees are effectively paying not only for the skill, understanding, talent and effort that was put into developing the know-how and reducing it to material form, but also for the time value of not being kept out of the potential market while the know-how is being developed from scratch. The licensing of the technology is effectively a shortcut to market for the licensee. As a licensor, it is important to have the steps and timescale of development of the know-how available so that it may be recognised as imparting value to the transaction, and so that part of the royalties may be allocated to this benefit (or possibly even additional royalties).

It is important that licensees, through effective technology transfer, get all the information required for the business model to be implemented as quickly as possible, so that revenue streams will be forthcoming as soon as possible. A properly documented set of know-how will ensure that they are capable of doing just that.

Defining know-how in licences

Practitioners should be careful when defining know-how in a licence agreement. The term encompasses all confidential proprietary information, as well as non-confidential proprietary information. A definition of know-how should include any information which is readily available to the public but which, through the skill and effort of the proprietor (or its employees), has been compiled into a usable format and has value. In other words, know-how need not necessarily be confidential information – as long as that particular compilation of information is proprietary to the licensor and adds value to the business.

As an example of this, let's say a manufacturer has, through the skill and

effort of its talented employees, developed a range of compressors. The technology on which this range of compressors has been based is well known, the materials out of which these compressors are made are well known and specifications for them may be available in any technical library. However, this particular compilation and application of publicly available information has resulted in a valuable and exploitable set of diagrams, production specifications and manufacturing procedures for each of the range of compressors. There is no reason why this information should not be protectable, and hence licensable, if it adds value to the business model.

The closer the development of the IP is actually to creating a revenue stream, the more value it represents and the more royalties it can command (up to a limit which is normally related to the sizes of the revenue streams and/or other strategic considerations). Franchise-type licensing agreements effectively license all the various forms of IP for what is generally already a proven business model. Where the business model is a proven one, the royalties payable are normally directly related to the size of the revenue streams that it enables.

IP relationship analogous to human relations

It is interesting that IP may be viewed as being analogous to the field of human relations in some respects.

Where many forms of IP have been developed around a particular product or service, the value added by all of the combined IP is more valuable than just the sum of the individual parts of the IP. This is similar to the concept of teamwork, where the value of the team is more than the sum of the individuals. As an example of this IP teamwork, one may look at how the various IP creates barriers to entry that seem to work against competitors from all sides. The patent will protect the base concept for a start, making inroads into the business a risky prospect right from the start, but then potential competitors must also take into account the fact that they will need a prototyping phase (the time barrier) and would probably still not be able to make the products at a cheaper price or better quality; to top it all off, competitors would then still have to battle brand recognition in the public for the original product. If starting a new business is tough, starting it against a well set up team of IP will prove even tougher.

Another analogy with human relations is that all the forms of IP work better together

when they have a focus or vision – ie, they are developed with a specific objective in mind. The nature of this objective may vary from that of an entrepreneur in commercialising a product, to the strategic objective of a multinational corporation in identifying and planning to become a future major player in a particular field of technology. It is obvious that the chance creation of IP as an offshoot of normal business will in general never be as effective as when the IP is created with a specific objective in mind. Licensors should keep this in mind, so that the next time that a business strategy is being thrashed out in the boardroom, they can keep one eye on ways to maximise the future IP value that is to be developed.



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Mike specialises in the filing of patents (particularly in mechanical, e-commerce and electrical/electronic inventions) and designs, as well as the drafting of licence agreements, software licensing, copyright issues, IP valuations and IP management consultancy.