

COURSE 9, TUTORIAL 6

LICENSING SBIR/STTR TECHNOLOGIES AND DATA



Today we are going to discuss licensing SBIR/STTR Data and technologies. Consider licensing a permit to use, just like your driver's license allows you to use the public roads. It is a permission to drive an SBIR/STTR technology and there are rules connected with it. The licensee will have to stay in the agreed upon lane. We will call these lanes "fields of use". We are going to talk about the many issues that relate to licensing, both in the federal contracting environment and in the commercial sector. We will discuss critical elements of a license, why the SBIR or STTR-funded firm cannot transfer Phase III rights through a license, and how an SBIR or STTR firm can license with a prime through a subcontract.

As in the prior section, we will refer to SBIR/STTR as SBIR, for convenience. The Data Rights for both are identical, and they use the same clauses. Below, the term "SBIR" whenever it is used will also refer to STTR, unless otherwise noted.

Licensing under a patent is very common. But if the SBIR firm did not patent, and is protecting its SBIR Data by means of the government's nondisclosure obligation, then licensing will permit another firm to use the small firm's SBIR Data and its underlying technology. The SBIR firm owns its SBIR Data and the government receives a license in it. A prime federal contractor may wish to use the SBIR Data and technology on a prime contract, and this can lead to a desire by the prime contractor to sublicense the SBIR Data. The SBIR firm should restrict the prime contractor's ability to sublicense the SBIR Data without the SBIR firm's consent. In contrast, a license to a commercial firm will normally result in a free-standing license of both the SBIR Data and the technology associated with it, or rights under a patent.

FIELDS OF USE

"Fields of use" establish the boundaries for use of the SBIR Data by the licensee, which is the receiver or beneficiary of the license. It is recommended that you limit the field of use to the extent possible. There are some common fields of use for federal contractors. When a large prime contractor seeks access to an SBIR technology, limit the field of use to performance on the prime's contract, grant, or other funding agreement. That limitation is quite common. It is a wise policy for the SBIR firm to seek a subcontract to the prime so that it can monitor the prime's use of the SBIR Data and technology and assure that they are being implemented correctly. A wider use would be to allow the prime contractor's use of the SBIR Data or technology on the program referenced in the contract—for instance, the AEGIS program or a NASA funded program. That is a much broader license because the prime contractor may get additional program contracts that don't include the SBIR firm. Yet the prime contractor would still have a license to use the SBIR Data and technology for the performance of the additional pro-



"Fields of use" establish boundaries



Expanding the field of use

gram contracts. An even wider field of use would be an agency-wide license for use with a particular agency or an agreement that would allow use of the SBIR technology under any funding agreement with the federal government. That license would prohibit use only in the commercial market, and should constitute the widest license granted in the federal market.

SBIR Data Rights require special handling in licensing. The SBIR-funded firm must protect its SBIR Data from nondisclosure in any license. A license is a permit to use but may not address nondisclosure. Be certain that a nondisclosure agreement is in effect. The nondisclosure agreement can be written into the license if one does not already exist, or the pre-existing nondisclosure agreement can and should be incorporated by reference into the license. This is particularly important when the SBIR-funded firm is a subcontractor to a prime contractor under either a civilian agency or defense prime contract. This situation might arise when the original subcontract was for services, but the prime contractor decides to amend the subcontract to include access to SBIR Data. The existing subcontract may not contain nondisclosure obligations, which should be then included.

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Prime contractors will always seek the widest field of use. They want to avoid restrictions, and so the field of use will become a negotiating item. The wider, or broader, the field of use, the harder the license is going to be to enforce and prove that the licensee operated outside that very broad field of use. Obviously, license fees or royalties should increase as the field of use widens. That is because the licensee's broadening field of

use narrows the other markets within which the SBIR firm can make money on the technology and generate a return on its investment in developing it.

CAREFULLY DEFINE WHAT IS BEING LICENSED

An important task for the licensor is to define what is being licensed. The license will normally refer to that as Confidential or Proprietary Information. This Confidential or Proprietary Information will undoubtedly include SBIR Data, but may also include proprietary information that was not developed under prior SBIR work. Define this "Confidential Information" accurately. This ensures enforceability of the license. Include only what the SBIR firm wants to license in the definition of "Confidential Information" and nothing the firm does not wish to license. Hence, the need arises for a precise definition of "Confidential Information."

Pay close attention to use of the terms "exclusive" and "non-exclusive" in licenses.

An exclusive license technically would allow use only by the licensee, and thus, would exclude the licensor, the SBIR firm, from using the SBIR Data or Confidential Information after the license is executed. That result may be wholly unintended. Thus, be careful about using the term "exclusive license." "Nonexclusive" may be a preferable term because it would allow continued use by the licensing SBIR firm as well as by the licensee, which could be the prime contractor. The SBIR firm's right to continue to use the SBIR Data and technology will allow the SBIR firm to continue to compete for Phases II and III applications of the technology. If the intent is to have more than one entity have access to the SBIR Data or Confidential Information, then the term "nonexclusive" is appropriate. Then expressly list all the firms,



including the SBIR firm, which will have access to the Confidential Information under the license.

LICENSE FEES AND ROYALTIES

Another issue in federal contract licensing relates to license fees. SBIR firms subcontracting to a large prime contractor with the federal government want to know whether they can charge license fees to the prime contractor. The government may object to such fees, claiming that it already owns the SBIR Data because it funded prior SBIR awards. That is simply incorrect. The SBIR firm owns the SBIR Data generated under an SBIR award. The government receives only a paid-up, royalty-free, world-wide, non-exclusive license to practice SBIR Data on behalf of the government. The government is subject to a nondisclosure obligation with respect to the SBIR Data. Policy Directives when new Phase III funding agreements are obtained.

This government license to use an SBIR technology applies only to the government, does not allow prime contractors to use SBIR Data, and does not allow disclosure of SBIR Data outside the government. Thus, if the government desires to provide any entity outside of the federal government access to the SBIR Data, then it must direct the SBIR firm to do something the government cannot do – disclose the SBIR Data to that entity. (The exception to this is that defense support contractors can have access to SBIR Data for evaluation purposes.) To do so, the SBIR firm would have to negotiate a license with the prime contractor, involving attorneys' fees and other types of transaction costs. The SBIR firm can recover these and other costs in license fees charged to the prime contractor. Under SBIR rules, the government receives a license to use SBIR Data, but does not own it. The key reason that license fees are justified in this situation is because of the non-disclosure provision. The SBIR firm is disclosing its SBIR Data to the prime contractor because the government cannot do so.

The subject of how to calculate license fees leads to frequent questions. License fees are dependent on the type of SBIR technology, the SBIR Data or Confidential Information that is being licensed, the market for them, how critical the technology is, and other factors. If the technology is a very large or specific item, with a narrow market allowing for few unit sales, then a larger license fee per unit may be in order. If the eventual product is much smaller and more numerous, then a smaller license fee per unit may result. License fees also may be dependent on the SBIR firm's business model. If the business model revolves around making money solely from license fees, that alone may

require increased license fees for the SBIR firm. However, harnessing a large firm's capabilities to assist in commercializing the eventual SBIR product may result in much smaller license fees, or none at all. In that case, profits from eventual sales of the product may serve as the SBIR firm's business model. The stage of development may also affect the ability to exact license fees. A technology closer to a final product may exact more in license fees than a more speculative technology in the earlier stages of development. Additionally, the degree to which proprietary information is included in the Confidential Information may affect the amount as well. Another factor in establishing license fees is the critical nature of the technology. If the technology is absolutely critical to an agency, that fact alone may lead to higher license fees. All of these things weigh heavily in license fee negotiations.

In negotiating license fees, first attempt to calculate how many units the SBIR firm estimates it can sell across a reasonably defined market. Second, determine a dollar amount per unit that can reasonably be expected. That will provide insight into the total expected market. Then estimate the market percentage the SBIR product can reasonably expect to penetrate. The SBIR firm should then compare this dollar total to the total required to recover the costs invested in the product, plus a reasonable profit. If the per unit cost across the anticipated percentage of the market does not allow for cost recovery and a profit, then adjust the unit rate upward.

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Determine market size



LICENSING AND SUBCONTRACTING

Licensing in the context of federal contracts involves two basic models. If the SBIR firm has a subcontract with a prime contractor, the license can be included as a few paragraphs in the subcontract. Alternatively, a license can be executed as an independent, freestanding agreement.

Negotiating a freestanding license is preferable because it has its own terms. It is tailored to the specific situation. Adding a license to a subcontract is less preferable and must be done carefully. When attempting the latter, carefully examine the definitions you have in the subcontract and don't just incorporate them – they may or may not fit the license agreement. Review the definition of Confidential or Proprietary Information to ensure that it accurately defines what is being licensed. Review fields of use and duration of the license carefully. These may differ from terms used in the subcontract.

Licensing in the government contracts market differs from licensing in the commercial market. Different terminologies are used. We tend to refer to payments received for sale of commercial products as **royalties**, but in the government contracts area they are referred to as **license fees**. They are the same thing. The commercial firm will definitely seek a license under any SBIR firm patents.

A license does not transfer Phase III SBIR rights. Phase III rights include the right to receive sole-source Phase III funding agreements. In a license, the SBIR firm allows use of its SBIR Data and/or technology by another party but continues to retain ownership of that data and technology. A license bestows a right to use, but not ownership. So a license cannot bestow Phase III rights on the licensee. That is because the SBIR firm continues to retain ownership of the technology and data and continues to retain sole-source rights itself in the technology. Two firms cannot demand sole-source rights at the same time. Phase III eligibility rights have to exist in only one firm at a time. So, a license, which grants the right to use, cannot convey Phase III eligibility rights. Only a sale or assignment can accomplish that. That is one way that a large firm legally can inherit Phase III eligibility to receive sole-source contracts from the government for SBIR technologies – it can acquire the SBIR firm or its technologies. This has happened successfully and often in the past. We hope this presentation on licensing SBIR Data and technologies has been helpful.

Prepared by
David Metzger, Esq.

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