Royalty Rate and Deal Terms Survey Results in the Chemicals, Energy, Environmental, and Materials Sector

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In 2009, LES conducted the inaugural Chemicals, Energy, Environmental, and Materials Committee ("CEEM") Royalty Rate and Deal Terms ("RRDT") survey. This survey, which included responses from CEEM members from both LES USA and Canada as well as LES International, covered a multi-trillion US dollar segment of the economy ranging from specialty chemicals to renewable energy to minerals and mining to packaging materials. The data submitted were from 2006 through 2009 and included flat running royalty rate, tiered royalty rate, and lump sum deals.

While the royalty rate is surely the most talked-about metric when comparing licensing deals, it is by no means the only component of a deal. Two of the goals of the 2009 survey were to determine (a) the importance of Other Financial Components (e.g., upfront and milestone payments) and (b) the use of Other License Components (e.g., audit and take back provisions and other non-financial components). The survey confirmed that comparing deals based on royalty rates alone is an "apples-to-oranges" comparison. Further, the survey highlighted an interesting polarity in the use of Other License Components that deserves further investigation.

Figure 1 illustrates the impact of Other Financial Components on the flat running royalty rate. The average flat running royalty rate based on 37 CEEM deals was 5.25%, the average for deals with no Other Financial Components was 6.57% while the average for deals with Other Financial Components was 4.12%. Deals with upfront payments averaged 2.83% while deals with milestone payments averaged 2.91%. Interestingly, deals where the licensee invested in or made loans to the licensor ("Other") averaged 4.44%.

Figure 1 - Flat Running Royalty Rate vs. Other Financial Components

(Note: some deals contain multiple Other Financial Components)

Figure 1 illustrates that royalty rates are not set in a vacuum relative to other components of the deal. As the licensor uses Other Financial Components, particularly upfront and milestone payments, to de-risk the uncertainty of its return and/or minimize its own direct investment in commercializing the product or technology, the licensee offsets its increased risk and/or cost by retaining a larger share of the back-end profits through payment of a lower royalty rate. On average, the data suggest that licensors are willing to give up 37% of the flat running royalty (=1-4.12/6.57) to obtain Other Financial Components. Deals where the licensee invested in the licensor (Other) yield a higher royalty rate because the licensee received a share of the licensor's cut.

Figure 2 displays the usage of certain Other License Components. Figure 3 highlights an intriguing polarity between deals with many (4+) and no Other License Components.

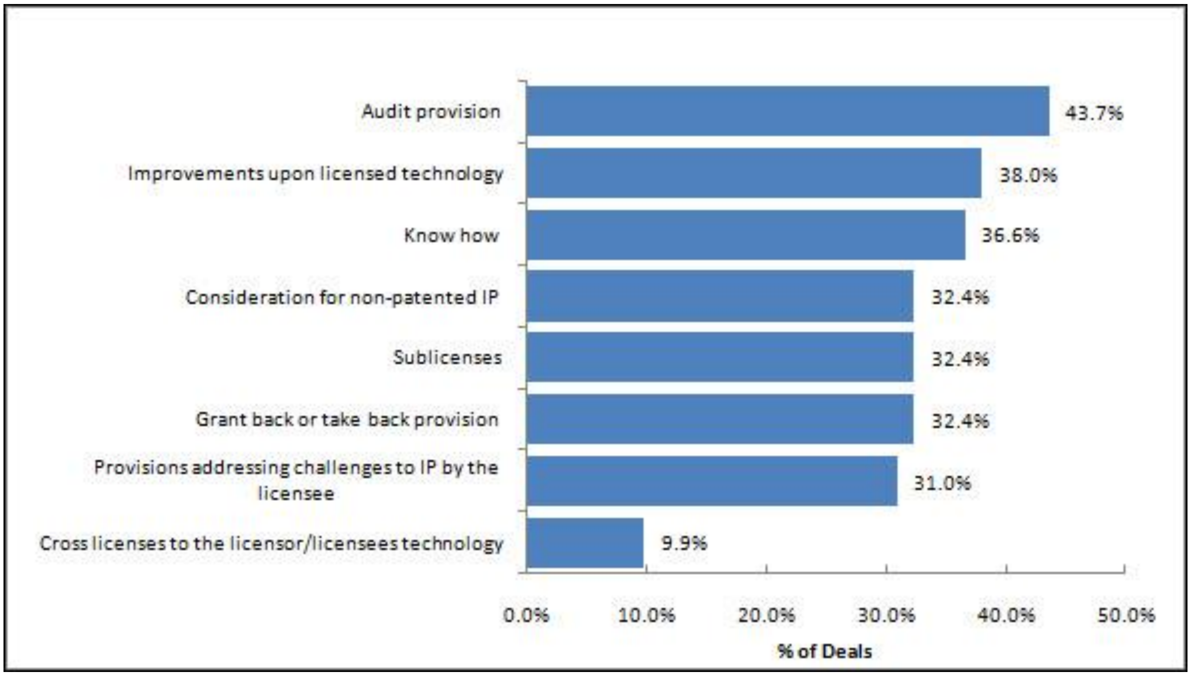

Figure 2 - Frequency of Use for Certain Other License Components

The data in Figures 2 and 3 have provoked some debate over whether the results reflect idiosyncrasies in the deals submitted to the survey or the experience level of licensing professionals. The results may be due to a little bit of both. For example, the fact that only 44% of total deals submitted (total=71) required audit provisions should not be taken to mean that 56% of licensors do not care if they are accurately compensated by the licensee! There may be several reasons other than experience, including expediency, cost to administer, hassle factor, and confidentiality, that restrain audit provisions. Regulatory uncertainty associated with developing the licensed product or technology and ambiguously drafted clauses may restrain the use of take back provisions. On the experience side, there are certain companies, institutions, and industries where licensing is relatively common and others where licensing is not so common.

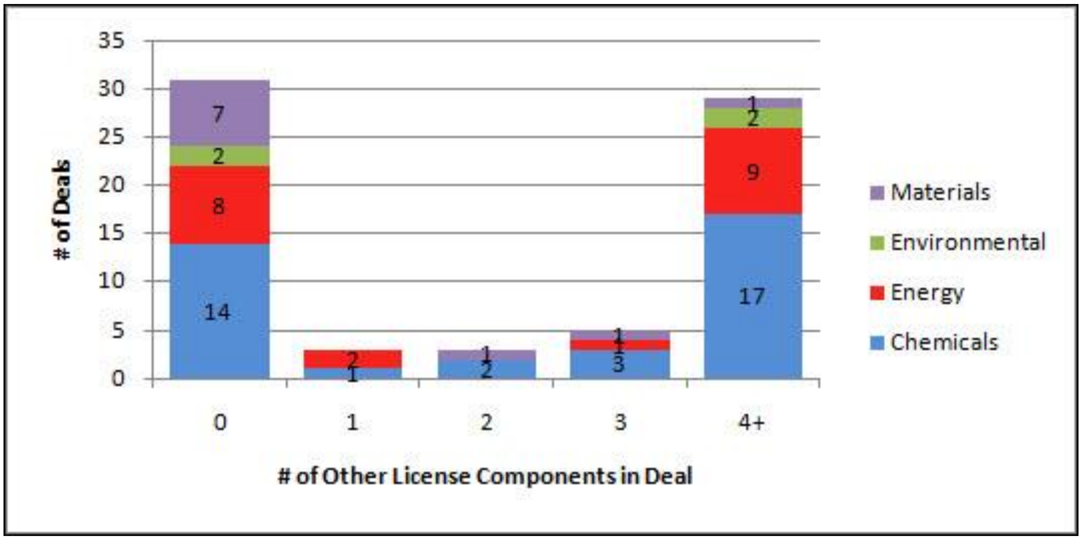

Figure 3 - Prevalence of Other License Components

In summary, in addition to providing a wealth of deal data in the **report**, the 2009 CEEM RRDT survey illustrates that comparing deals based on royalty rates alone is an "apples-to-oranges" comparison. The presence of Other Financial Components, such as upfront and milestone payments, can materially impact the royalty rate. Additionally, the use of Other License Components, such as audit provisions, is not uniform. The split of Other License Components between deals with many such components and deals with none is intriguing and, provides further basis for continuing education for licensing professionals.

The **full survey report**, with over 100 pages of analysis and data, is available exclusively to LES (USA and Canada) members.