

PROBLEMATIC CLAUSES IN THE DRAFTING OF LICENSING AGREEMENTS

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INTRODUCTION

The following are notes for the presentation to be made at the Advanced Licensing Course of the Licensing Executives Society (U.S.A. and Canada), Inc. to be held in Vancouver on April 19 and 21, 1998. They constitute a brief summary of the key legal considerations in the drafting of the following clauses: Grant of rights, Field of use, Most-favoured-licensee and Best efforts. Annex AA» which follows is a sample of clauses concerning each of such clauses.

GRANT

The grant provision is the essence of a licensing agreement because it establishes the subject matter of the licence and the rights that are to be extended to the licensee. If this clause is unclear or improperly understood, it could result in a dispute between the parties which may eventually require the interference of the courts.

The language used in licensing agreements can sometimes be ambiguous. A term that is known to mean one thing in one country may not be known to have the same meaning in another country.¹ This is especially true when distinguishing between the grant of an «exclusive», «sole», and «non-exclusive» licence. The grant of an exclusive licence customarily precludes the possibility of withholding a right. However, in some countries, the word «exclusive» standing alone can be

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¹ KARNELL, Gunnar W.D. and Eric M. ANDERSSON, *Introduction to International Licensing*, London, Intellectual Property Publishing Limited, 1988, p. 21.

ambiguous because although it certainly means that no other licensees can be contemplated, it is not always clear whether the licensor has also reserved for himself any of the licensed rights (this is usually referred to as a «sole» licence).

The words «sole and exclusive» are sometimes used together to describe an exclusive licence but should be avoided because in reality the terms are contradictory. Furthermore, a term like «open exclusive licence»² which is sometimes used will not necessarily mean the same thing for one person as it will for another. In such cases it is essential to include further descriptive language in order to have no doubt as to the legal character of the licence being granted.³

The grant provision must also foresee the right to either make, use or sell the licensed product or a combination of them. When the grant provides for the right to «make, use and sell», the patentee is completely waiving his right to exclude the licensee from enjoyment of the patented invention within the territory to which the patent pertains.⁴ It is therefore viewed as not necessary to use words such as «Have made,...lease,... or otherwise dispose of...» If such words are used, the courts may be forced to interpret the clause restrictively since there has been a departure from the common language used in these clauses.⁵ Hence, it is not always wise to try and clarify by adding more legal terms which are not necessary because it could have the opposite effect and may cause confusion. If they must be used because of surrounding circumstances, they should be used in a non-limitative list.

The right to make, use and sell, although often seen together are separable. However a grant that only provides for the right to make the product would be useless without the additional right to either use or sell such a product. It is therefore very likely that when the grant provides only for the right to make the product, the courts will also imply a right to use or sell.

² Ibid. (Open exclusive licence means that the «exclusivity relates solely to the contractual relationship between the licensor and the licensee , whereby the licensor merely undertakes not to grant other licenses in respect of the same territory and not to compete himself with the licensee on that territory, but where there is no indication that the parties aim at eliminating competition from, for example, parallel importers or licensees for other territories».

³ GOLDSCHIEDER, Robert, *The New Companion to Licensing Negotiations: Licensing Law Handbook*, New York, Clark, Boardman, Callaghan, 1996-97, at p. 70.

⁴ MAYERS, H.R., and B.G. BRUNSVOLD, *Drafting Patent Licence Agreements*, Washington, BNA Books, 1991, p. 57

⁵ Ibid.

FIELD OF USE

The field of use provision requires careful and precise drafting in order to clearly separate the various fields of use which are often too finely divided. The difficulty lies in trying to divide fields of use in areas where the technologies are complex and there is a high potential for overlap between the licensed products. The task becomes even more challenging when the usefulness of technology has yet to be proven.⁶

In order to avoid disputes, the licensor should attempt to licence uses that are indeed separable and non competitive. A problem that may result from the inclusion of such a clause in the licensing agreement is the division of a naturally competitive market, which in the U.S. gives rise to antitrust issues. When the division is a commercial one instead of a technical one the interference in natural competition is even more apparent. For example, if the licensee is prohibited from selling to companies and can only sell to individuals, he is being refused access to a substantial part of the market. Nevertheless this type of separation has been found to be legal by the US Courts.⁷ Furthermore, this type of provision restricts the potential for initiative and expansion on the part of the licensee who is limited to a specific use of the licensed product. In effect, it prohibits the licensee from realizing the benefits of the licence in certain technical fields.⁸

When the field of use covered by the licence is not clearly defined, the licensee may be tempted to exploit unexpected uses of the licensed technology which might develop. This will be disadvantageous to the licensor who negotiated the original agreement with only a certain use in mind and who is receiving royalty payments to reflect only that portion of the use while the licensee is receiving sufficiently more than he bargained for. A «field of use clause» should therefore identify the precise field agreed upon by the parties and maintain to the Licensor any new fields not foreseen or foreseeable on the day the Agreement is executed.

Restriction on the use of a product will not be inferred if there is no express term in the agreement to impose a possible restriction. In *Union Industries Inc. v. Beckett Packaging Ltd.*⁹, the Court came to the conclusion that in the absence

⁶ RAMSAY, John T., *Technology Transfers and Licensing*, Toronto, Butterworths, 1996, p.127

⁷ *General Talking Picture c. Western Electric Company* 304 U.S. 175 (1937) affd. on reh'g, 305 U.S. 124 (1938).

⁸ MEYERS, T.C., «Field-of-Use Restrictions as Procompetitive Elements in Patent and Know-How Licensing Agreements in the United-States and the European Communities» (1991) 12 *Northwestern Journal of International Law and Business* no.2, p. 364 at p. 366

⁹ 48 C.P.R. (3d) 523

of any explicit restrictions, when a purchaser acquires a licence for a patented item, he or she receives a licence to deal with the item in any way.

MOST-FAVOURED-LICENSEE

In the most cases, the licensor who is entering into a licensing agreement should do everything possible to avoid including a most-favoured-licensee provision in the agreement. The licensee on the other hand will want to include a provision where he is treated equally with a subsequent licensee if not fairer. If the parties do decide to include such a clause in the agreement, it should be drafted very carefully.

In a recent American decision, *Studiengesellschaft Kohle, m.b. v. Hercules Inc.*,¹⁰ we see the disadvantages that could arise for a licensor who includes a most-favoured-licensee provision in the licensing agreement. In this case, the Court was forced to conclude that the licensor had breached the licensing agreement where he had failed to inform the licensee of a licence that he had granted to a subsequent licensee. The original licensee had managed to have included in the agreement a very broad most-favoured-licensee provision and when the time came to have it interpreted, the Courts had no choice but to rule in the licensee's favour.

The biggest problem with this type of provision is that not enough thought is put into the content and not enough limitations are placed on its applicability. In negotiating this type of clause there are certain factors that need to be taken into consideration as possible restrictions to the clause such as:

- a time constraint could be placed in the licence;
- there could be a limitation to specific patents and/or pending applications;
- the most-favoured-licensee clause should be limited to non-litigation related licences;¹¹
- how and when the transferor will notify the licensee of the details of the other licence;
- a territory or field of use in which the favourable terms apply;

¹⁰ 105 F.3d 629 (Fed.Cir. 1997)

¹¹ McGURK, Michael R., «Problems of Careless Drafting», *Les Nouvelles: Journal of the Licensing Executives Society*, Vol. 32, No. 3, (1997), p. 148

- the duration of the more favourable terms;
- the method of valuing non-cash consideration (for examples, cross-licences or equity);
- whether the adjustment will be retroactive;
- how to deal with prior licences; and
- how the licensee will elect to accept the most-favoured-licensee clause, if the adjustment is not made automatically.

If such a clause is to be included in the agreement, the licensor should require that the licensee be forced to accept all the terms that appear in the more favourable agreement rather than allowing him to choose only selected terms that are to his advantage.¹²

BEST EFFORTS

The difficulty arising from this type of provision is in defining the term «best effort» and in deciding what type of effort can be considered as the «best» effort. Although this term is widely used in licensing agreements, the uncertainty over legal treatment of such a provision impedes the ability of contracting parties to contract effectively.

Over the years, the courts have been called upon on several occasions in order to interpret «best efforts» clauses. Each time, the courts have been inconsistent in the treatment of the clause and it is therefore impossible to deduce the normal or usual extent of the obligation placed on licensee (or licensor) who is bound to put forward his best effort in marketing or developing a certain product.

In *Bloor v. Falstaff Brewing Corp.*,¹³ the Court was of the opinion that the best efforts obligation was violated even though the sale of product was highly unprofitable. However in *Western Geophysical Co. v. Bolt Associates, Inc.*,¹⁴ the best efforts obligation was held to be satisfied even though no device had been made or sold. This was due to the fact that the device was not mechanically sound and Western was putting its efforts into trying to improve the mechanical

¹² Supra, note 1, p. 129

¹³ 601 F.2d 609 (2nd Cir. 1979)

¹⁴ 584 F.2d 1164 (2d Cir. 1978)

reliability of the device before putting it on the market. However the efforts put into developing the product were seen by the Court as being sufficient to satisfy the contractual obligation of using «best efforts».

In *Zilg v. Prentice-Hall, Inc.*,¹⁵ the test used for deciding whether «best efforts» had been used was limited to whether the product had been given a reasonable chance of achieving market success. The test used to by courts in determining whether the obligation of «best efforts» is being satisfied is a subjective test as opposed to an objective one. This test would take into consideration the potentialities of the licensee's business and the circumstances that might arise to affect it. The party with such an obligation can only be asked to do that which is reasonable to be expected of such party under the circumstances surrounding it.¹⁶

However, some Canadian courts in defining the term «best efforts» in contracts other than technology transfer agreements, seem to equate the «best efforts provision» to an obligation to «leave no stone unturned» to fulfill the obligation of the party subject to the best effort provisions.¹⁷ This would impose a tremendous obligation upon the licensee to ensure that every single possibility for exploiting or efficiently marketing the product has been thought of and that no angle has been neglected. Such an obligation would imply a substantially greater effort to be given by the licensee than that which is usually required to satisfy this type of obligation by the American courts.

Implied Obligation of Best Efforts

Courts also have had to decide whether, in the absence of an express obligation to that effect in a contract, the licensee is bound to the performance of «best efforts» arising from an implied obligation. This issue was dealt with in detail by the U.S. Court of Appeals in *Permanence Corporation v. Kennametal, Inc.*,¹⁸ The Court acknowledged that such an obligation has sometimes been inferred in certain circumstances where for example «no advance payments were made and the licensor had to rely entirely on the good faith of the licensee in order to receive any consideration in return for the grant of the exclusive agency.»

¹⁵ 717 F.2d 671, cert. denied, 466 U.S. 938 (2nd Cir. 1983)

¹⁶ *Respirex of Canada Ltd. v. Flynn* (1975), 22 CPR (2d) 104 (Ont. H.C.) affirmed (1978) 41 CPR (2d) 74(Ont. C.A.)

¹⁷ *Sheffield District Railway Company v. Great Central Railway Company* (1911), 27 TLR 451 also followed in *C.A.E. Industries Ltd. v. R.*, (1983) 2 F.C. 616 (F.C.T.D.)

¹⁸ 908 F.2d 98 (6th Cir. 1990)

The argument of the licensor in this case was that the provision for royalty payments implies a best efforts obligation because royalties will only be generated if the defendant is under a duty to exploit the patented process. However the Court came to the conclusion that a substantial minimum or advance royalty payment provides sufficient incentive and demonstration of good faith by the licensee to devote best efforts for the development of the technology, and that an implication of a best efforts obligation need not be made. In addition, the Court stated:

Especially, as is true in the present case, when an inventor grants a licence to patented technology, the application of which is unknown, a commitment on the part of the licensee to devote best efforts to the development of the technology is a substantial commitment which should not be automatically inferred.

In light of this, it would seem that a licensor or licensee who wishes to obtain an obligation of best efforts from the other party should make sure to include an express obligation to this effect in the agreement itself.

Alternatives to the «Best efforts» clause¹⁹

The following are some alternatives or particulars to be added to the «best efforts» clause:

- the priority of developing the licensed product can be stated in relation to other products and technologies that are being developed at the time of the contract formation;
- the priority of the new product to be developed could be stated relative to the product lines of the company in terms of per item profit, sales volume, historical importance to the company etc;
- the limitations of the budget and workforce of the company could be stated as limitations on a «best efforts» obligation;
- minimum and maximum commitments of man-hours and expenses could be detailed;
- work to be performed could be outlined in some detail, etc.

It is therefore preferable to specify minimum performance requirements rather than broad, vague terms such as «best efforts» or worst for the Licensor, «reasonable efforts».

¹⁹ For an outline of the alternatives and examples, see SHIFLEY W. and B.J. HULBERT, «Best efforts may not be the best advice», *Les Nouvelles: Journal of the Licensing Executives Society*, Vol. 27 no. 1 (1992) p. 37

CONCLUSION

In conclusion, it is important to note that, while the use of standard models or model clauses may be helpful in drafting agreement, they will never replace sound judgments and careful consideration on the part of the parties and the drafter(s). It is essential to read each clause and carefully adapt it to each particular case in order to provide each party with a licensing agreement suitable for his needs. Remember, a Most-favoured clause» will always be good for the Licensee not so for the Licensor and its inclusion or exclusion will often depend on who holds the better end of the stick.

ANNEX «A»

SAMPLE CLAUSES TO PROBLEMATIC CLAUSES IN THE DRAFTING OF LICENSING AGREEMENTS

DEFINITIONS

- 2.1.1 **"Affiliate"** means, with respect to a party to this License Agreement, (a) any Entity in which such party or any of its stockholders, directors, or officers has a direct or indirect ownership interest of fifty percent (50%) or more of the voting shares, or (b) any Entity which, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with such party. The term "control" means possession, direct or indirect, of the powers to direct or cause the direction of the management or policies of a person or Entity, whether through ownership of equity participation, voting securities, or beneficial interests; by contract; by agreement; or otherwise.
- 2.1.7 **"Derived Materials"** means all products now or hereafter produced by the Licensor, its Affiliates in accordance with the Licensed Technology which incorporate or make Use of the Product in its composition and all related Know-how, including, without limitation, all the products now known as(□) the specifications of which are set out in Appendix "□".
- 2.1.8 **"Derived Materials Applications"** means all Know-how relating to any application of any Derived Materials, including, without limitation, the list of applications provided in Appendix "□".
- 2.1.11 **"End User"** means any Entity directly or indirectly authorized to Use the Licensed Products for incorporation in its own products, or any Entity licensed to Use such portion of the Licensed Process necessary to produce a specific Derived Material Application in the regular conduct of its own business and not for Sale or license to other Entities.
- 2.1.12 **"Engineering Design Information"** means all information, manuals and data relating to the construction of the Plant in sufficient detail to enable competent engineers to successfully complete the design, configuration and construction of the Plant and shall include, without limitation, all the information listed in Appendix "□" and shall be transferred and disclosed to the Licensee in accordance with the provisions of section □.
- 2.1.15 **"Future Patent Rights"** means all patent applications, patents and industrial designs (or design patents) which may be applied for, owned

or controlled anywhere in the Territory by the Licensor, within the scope of the Licensed Technology.

- 2.1.17 **"Know-how"** means the skill or ingenuity based upon the body of knowledge which comprises all of the methods, processes, designs, engineering information, formulas, manuals, guidelines and all other information and data relating to the Licensed Technology or any part thereof which the Licensor develops, employs in its own activities, or has available for Use during the term of this License Agreement.
- 2.1.19 **"Licensed Process"** means the formulas, processes and methods developed, owned or controlled by the Licensor for the manufacture, development and production of the (Polymer).
- 2.1.20 **"Licensed Products"** means the (Polymer) and the Derived Materials.
- 2.1.21 **"Licensed Technology"** means all of the Licensor's technology, intellectual and industrial property, including, without limitation, inventions, designs, computer programs, formulas, recipes, technical data, apparatus, training material, operating and maintenance guidelines, procedures, Know-how whether patentable or not protectible as Trade Secrets or not, relating to: (i) the (Polymer), the production thereof and process related thereto; (ii) the Derived Materials, the production thereof and process related thereto; (iii) the Plant and equipment information required for the production and manufacturing the () and all Derived Materials, including, without limitation, the Engineering Design Information; (iv) the Licensed Process; (v) the Derived Materials Applications, the production thereof and process related thereto as they exist at the Effective Date; (vi) any Improvement made or controlled by the Licensor relating directly or indirectly to the Licensed Technology during the term of this License Agreement; and (vii) all Future Patent Rights which may be granted to or vested unto the Licensor during the term of this License Agreement in relation to the above.
- 2.1.26 **"Sale"** or **"Sell"** means a transaction for which consideration is received by the Licensee for the Sale of Licensed Products; a Sale of Licensed Products shall be deemed completed at the time the Licensee bills, invoices, ships, or receives payment for such Licensed Products, whichever event occurs first.
- 2.1.29 **"(Polymer)"** (The base product subject of the technology) means the basic () materials, known as "()", obtained by using the Licensed

Process and all related Know-how, including, without limitation, all specific types of (□) set out in Appendix "A".

- 2.1.32 **"Use"** means any form of practice or utilization of the Licensed Technology, the Licensed Process and the Licensed Products, or any portion thereof.

3. LICENSE RIGHTS GRANTED

3.1 Grant of Rights

- 3.1.1 Subject to the terms and conditions of this License Agreement, the Licenser hereby grants to the Licensee the exclusive right (exclusive even against the Licenser) to, directly or through an Affiliate: (a) Use the Licensed Technology within the Territory without restriction except as provided for in this License Agreement; and (b) make, Use and Sell all Licensed Products and Derived Materials Applications.

- 3.1.2 This grant will extend to and authorize the making, the using, the Sale or other transfer of the Licensed Products and Derived Materials Applications through an Affiliate, sublicensee or distributor, and shall authorize End Users to Use of Licensed Products and Derived Materials Applications transferred by the Licensee, its Affiliates, sublicensees or Distributors.

3.3 Patents and Patent Applications

With a view to ensuring that the exclusivity granted to the Licensee is maintained, the Licenser shall, immediately when so decided by the Licensee, apply or as the case may be, give the Licensee the power of attorney to apply in the Licenser's name and at the Licenser's expense, for all such patents, design patents, industrial designs as may be obtained for the Licensed Technology within the Territory which will form part of the Future Patent Rights as defined herein. In the event the Licenser grants a power of attorney to the Licensee, the Licenser shall assist the Licensee in the prosecution of any patent applications and shall execute such documents and do such things as may be deemed necessary to fully give effect to the provisions of this section, including, without limitation, securing the signature of all inventors on any such applications. If the Licenser fails to maintain any such patents, design patents, industrial designs or other intellectual property rights, the

Licensee shall have the right to maintain same in the name of the Licensor at the Licensor's expense.

3.4 **Rights Reserved**

This License Agreement shall not be interpreted or construed as granting to the Licensee any rights, express or implied, to any patents, patent applications, inventions, methods, technical information, Confidential Information, proprietary information, expertise, know-how, trade secrets, or knowledge other than the rights specifically granted by this License Agreement.

5. **DISCLOSURE OF THE LICENSED TECHNOLOGY AND TECHNICAL ASSISTANCE**

5.1 **Disclosure of the Licensed Technology**

Within the delays set forth in Appendix "G" (and from time to time thereafter), the Licensor shall disclose and provide the Licensee with the following:

- 5.1.1 all Know-how and technical information necessary or useful to produce the (Polymer) including, without limitation, all the information listed in Appendix "H";
- 5.1.2 all Know-how and technical information necessary or useful to produce the Derived Materials including, without limitation, all the information listed in Appendix "I";
- 5.1.3 all Know-how and technical information necessary or useful to produce or commercialize the Derived Materials Applications including, without limitation, all the information listed in Appendix "J";
- 5.1.4 the Engineering Design Information;
- 5.1.5 operating and maintenance guidelines of the Plant; and
- 5.1.6 a first draft of operating and maintenance instructions and procedures that are consistent with the(□) and required to achieve targeted performance characteristics in a safe and environmentally responsible manner to mutually agreed levels of detail.

5.2 Diligent Disclosure

5.2.1 All disclosure of the Licensed Technology by the Licensor in accordance with the provisions of section 5.1 above, including, without limitation, the disclosure of the Engineering Design Information, shall be made thoroughly and in a manner enabling the Licensee, its employees, engineers and consultants to carry out the transfer of the Licensed Technology as contemplated herein and to solve all problems relating to the construction of the Plant, the manufacture, production and Use of the Licensed Products and of all Derived Materials Applications.

5.2.2 Without limiting anything contained in this License Agreement and during the period of the Technology Transfer Phase, the Licensor shall provide the Licensee with all documentation and information and updates intended for the Use of the Licensed Technology, and shall make available to the Licensee by telephone, facsimile or in person, where reasonably warranted, the service of competent and knowledgeable technical personnel to confer with competent the Licensee technical personnel in order to facilitate the exchange of information, at the Licensor's expense.

5.3 Delays in the Technology Transfer Phase

In the event that any of the Know-how or other information, documentation or data, which must be disclosed and transferred within four (4) months of the Effective Date in accordance with the provisions of section 5.1 and the Disclosure Schedule (Appendix "G"), is not so transferred to the Licensee's satisfaction within this four (4) month period, the Licensee shall have the right to retain an amount of out of the second License payment in accordance with the Milestone Schedule (Appendix "E"). This amount shall be withheld by the Licensee until the expiration of () months after the Effective Date and shall then be paid to the Licensor only if the Licensee is satisfied that at the expiration of this eight (8) month period, (i) it has received all such Know-how, other information, documentation and data, and (ii) the Plant Start-up (as scheduled in the Milestone Schedule) has not been delayed as a result of any delay on the part of the Licensor in the transfer thereof. If, however the Licensee is not satisfied that 5.3(i) or 5.3(ii) is respected, then the Licensee shall have the right to deduct from such amount, an amount of twelve thousand five hundred dollars (\$12,500) per week until it is satisfied that it has received all such Know-how, other information, documentation and data and that a period equivalent to any delay in Plant Start-up resulting from any delay on the part of the Licensor in the transfer thereof has elapsed, and such

amount shall serve to decrease the license issue fees payable in accordance with the provisions of article 7. The provisions of this section 5.3 shall not apply (i) if the Licensee is unable to assimilate all the Know-how or other information, documentation or data and that the Licensee informs the Licensor of same by notice or (ii) if the Licensor gives notice to the Licensee that it will not meet the delays set forth in section 5.1 and that the Licensee, at its own discretion, grants a further delay to the Licensor, such further delay to be applicable only if put in writing by the Licensee.

5.4 **Technology Transfer Teams - Responsibilities and Obligations**

- 5.4.1 Each of the Licensor and the Licensee will form a Technology Transfer Team for the purpose of ensuring the timely and efficient transfer of the Licensed Technology from the Licensor to the Licensee. The Licensor's Technology Transfer Team will be constituted of persons who are in the employ of the Licensor or one of its Affiliates, who have an expertise in the Licensed Technology and who are capable of transmitting such expertise to the Licensee.

The Licensee's Technology Transfer Team will be constituted of the Licensee employees or consultants who need to know the Licensed Technology to efficiently and thoroughly carry out their respective responsibilities and have signed appropriate confidentiality undertaking in favour of the Licensor and the Licensee. It is agreed that all of the personnel of each of the parties including, without limitation, the members of its Technology Transfer Team shall give to the execution of the work their highest level of care, attention and consideration and in the case of the Licensor, as if the Plant were being constructed, Started-up and operated by the Licensor for its own account.

Attached herewith as Appendix "L" is the Technology Transfer Team of the Licensee and attached as Appendix "M" is the Technology Transfer Team of the Licensor. It shall be the responsibility of each party to ensure that all members of its team perform all their obligations provided for in this License Agreement. The Technology Transfer Team of each party shall meet regularly (but at least once a month) to coordinate the Technology Transfer Phase and the carrying-out of their respective responsibilities.

- 5.4.2 During the Technology Transfer Phase, the Technology Transfer Teams of each party shall have the responsibilities ascribed to them as per Appendix "N". However, the Licensor agrees that Appendix "N" shall not relieve the Licensor of any of its obligations under this License

Agreement, including, without limitation, its obligations to provide: (i) any modification of the Engineering Design Information deemed necessary by the Licensee in order to be adapted to the Licensee's specific operating conditions and all operating standards in force in the Territory as such standards may be disclosed by the Licensee to the Licensor in a timely manner (ii) revision of all outside contractors, designs, (iii) technical assistance to the construction engineers during the construction of the Plant and the Plant Start-up, and (iv) assistance to establish all adequate analytical methods and quality control procedures for raw materials and Sulphur Polymer.

5.5 **Training of the Licensee's Employees**

The Licensor shall, within the time set forth in Appendix "G", fully train a mutually agreed number of employees of the Licensee relating to the Plant operations and maintenance the manufacture of the Licensed Products and Derived Materials and the Derived Materials Applications.

It is contemplated that such course of instruction shall be first held at the Plant of the Licensor, or one of its Affiliates and then be completed at the Plant. All Know-how, technical data, assistance, and instruction to be given to the Licensee shall be in the English or French language. During the training of the Licensee employees, the Licensee shall only support the salary and the travelling expenses of its own employees.

6. PLANT PERFORMANCE AND WARRANTY TEST RUN

6.1 Completion of the Plant

The Licensee shall be responsible for the construction of the Plant in accordance with the Engineering Design Information disclosed and provided by the Licensor with a view to reaching Plant Start-up within eight (8) months from the Effective Date provided that the Licensor shall have fulfilled all its obligations and covenants provided for in this Agreement including, without limitation, the disclosure and transfer of all the Licensed Technology in accordance with the provisions of section 5.1. Notwithstanding anything contained herein, the Licensor shall review generally, from an operating standpoint and for practicability of the Licensed Process, all drawings prepared by or on behalf of the Licensee for the construction of the Plant and the Licensor will recommend all modifications which it considers necessary in order for the Plant to be constructed and operated in accordance with all specifications disclosed herein to form part of the Licensed Technology including, without limitation, to ensure compliance with the Engineering Design Information. For this purpose, the Licensor will forward to the Licensee, within five (5) business days of receipt of any such drawings, any comments and corrections to the Licensee.

6.2 General Plant Performance

6.2.1.1 Within thirty (30) days after being notified of Plant Start-up by the Licensee, the Licensor shall conduct a general Plant performance test of thirty (30) days or such shorter period as may be agreed upon in writing by the parties ("Warranty Test Run") which shall meet or surpass all performance standards provided in Appendix "O". The Licensor will provide the Licensee with no less than 72 hours advance notice of any Warranty Test Run. During a Warranty Test Run, the Plant will be operated and maintained by the Licensee's personnel in accordance with standard procedures described in the operating and maintenance guidelines provided by the Licensor pursuant to section 5.1.5 and in the first draft of operating and maintenance instructions and procedures provided by the Licensor pursuant to section 5.1.6.

6.2.1.2 Notwithstanding the foregoing, the Licensee may, at any time, waive in writing its rights to have a Warranty Test Run conducted by the Licensor in which case the Licensor shall be relieved of all obligations and liabilities with respect to the performance of the Plant.

6.2.2 In the event the Warranty Test Run made by the Licensor fails to meet all performance standards of Appendix "O", the Licensor shall:

- (a) if the failure is the result of a default in the engineering design of the construction of the Plant not attributable to the Licensor, then the Licensor shall identify such default and give notice to the Licensee of same and the Warranty Test Run shall be suspended until the Licensee gives notice to the Licensor that such default in the engineering design has been corrected, at which date the Warranty Test Run shall resume;
- (b) if the failure is the result of a wrongful execution of a given operation by an employee of the Licensee in the operation of the Plant not attributable to the Licensor, then the Licensor shall identify such wrongful execution and give notice to the Licensee of same and the Warranty Test Run shall be suspended until the Licensee gives notice to the Licensor that the faulty execution has been corrected, at which date the Warranty Test Run shall resume;
- (c) if the failure is the result of a malfunction in the process equipment which is covered by a manufacturer's warranty then the Warranty Test Run shall be suspended until the Licensee gives notice to the Licensor that the malfunction has been remedied, at which time the Warranty Test Run shall resume;
- (d) if the failure is not the result of a default other than those contemplated in subsection (a), (b) or (c) above, then the Licensor shall make all modifications or adaptations to the Plant or any part thereof required to be made to successfully meet the performance standards at its own cost and expense and, upon completion of such modifications, the Licensor shall have the right to perform one further Warranty Test Run in order to meet all performance standards provided for in Appendix "O".

All the modifications or adaptations to be made by the Licensor in accordance with this subsection 6.2.2(d) and the second Warranty Test Run shall be performed within a period of three (3) months from the date of the Plant Start-up.

6.4 **Warranties, Rights and Liabilities on Licensed Technology**

In addition to the representations and warranties contained in the preamble, the Licensor hereby fully warrants to the Licensee the adequacy and fitness of the Licensed Process and the Licensed Technology failing which section 12.4 shall apply.

7. LICENSE ISSUE FEES

Subject to sections 5.3 and 6.3, in consideration of the license granted herein, and services rendered by the Licensor, the Licensee shall pay to the Licensor an aggregate license issue fees of () dollars (\$) in accordance with the Milestone Schedule attached herewith as Appendix "E".

8. ROYALTIES

8.1 Earned Royalties

Subject to section 8.2, in consideration for the license granted in this License Agreement, the Licensee shall, in addition to the license issue fees provided for in article 7, pay to the Licensor, in the manner designated herein, an earned royalty of () on the Licensee's Net Sales of Licensed Products until the earlier of the expiration of this License Agreement or the time at which the total amount paid to the Licensor pursuant to this section 8.1 has reached, in the aggregate, () dollars (\$) .

8.2 Minimum Royalties

8.2.1 Minimum royalties in respect of the first three (3) years starting on the Effective Date royalties become payable in accordance with the provisions of section 9.1, shall be calculated as follows:

Year	Minimum Royalty
First year	\$(<input type="text"/>)
Second year	(<input type="text"/>)
Third year	(<input type="text"/>)

The minimum royalty for each of the three (3) first years, shall be payable by the Licensee to the Licensor irrespective of royalty payments for prior and subsequent years.

8.2.2 The Licensee shall use its best efforts to exploit the Licensed Technology in order to achieve the minimum royalties set forth in paragraph 8.2.1, however if the Licensee does not achieve such minimum at any time in any of the first three (3) years, it shall have the right at its own option either to (i), within forty-five (45) days of the end of a given year, pay to the Licensor the difference between the royalty paid for that given year and the minimum royalty requirements set forth in paragraph 8.2.1 or (ii) terminate this Agreement upon decision of the Board of Directors and be relieved from payment of such minimum royalty for that given year and from any other payment provided under this Agreement, provided that the Licensee will pay to the Licensor all amounts due, and the provisions set forth in section 12.3.4 shall apply.

8.3 Earned Royalty Adjustments

8.3.1 Should a substantial part of the Licensed Technology be placed, by a party other than the Licensee or an Affiliate of the Licensee, voluntarily or involuntarily, freely into public use, the Licensee may set off against any further royalty payments under this License Agreement any damages which it has suffered or which may reasonably be anticipated it will suffer as a result thereof, from the date such substantial part of the Licensed Technology is so placed in public use. Nothing contained within this Subsection shall prevent the Licensee from continual Use of the Licensed Technology or any part thereof whether such part is part of the public domain or not.

8.3.2 Should a claim be brought in any court or a request for reexamination be made of the proprietary nature of the Licensed Technology or in accordance with the provisions of article 11, all earned royalties payable by the Licensee to the Licensor, according to this License Agreement, shall be paid into an escrow account, acceptable to both the Licensor and the Licensee, and shall be held pending final determination of the challenge. If the challenge results in a final determination invalidating such proprietary nature of the Licensed Technology, all royalties held in escrow shall be returned to the Licensee together with all accrued interest. If all or a significant part of the proprietary nature of the Licensed Technology is upheld against the challenge, the escrowed royalties shall be paid to the Licensor.

9. PAYMENTS AND REPORTS

9.1 Payments

9.1.1 Any amount due to the Licensor as the result of each Sales of Licensed Products pursuant to the license rights granted by this License Agreement shall accrue at the time the Licensee receives payment for such Licensed Products. All amounts accrued for the benefit of the Licensor shall be deemed held in trust for the benefit of the Licensor until payment of such amounts is made pursuant to this License Agreement.

9.1.2 Unless otherwise specified in this License Agreement, all amounts due to the Licensor under this License Agreement shall be paid within thirty (30) days following the end of the Calendar Quarter in which such payment accrues or the Licensee otherwise incurs the obligation to pay such amounts.

9.1.3 All such payments shall be remitted to the Licensor's address given in the notification provision of this License Agreement or to such other address as the Licensor shall direct.

9.5 Reports

9.5.1 Each payment made to the Licensor shall be accompanied by a written report summarizing, in sufficient detail to allow the Licensor to verify all payment amounts, the data used to calculate the amounts paid. Each report pertaining to royalty payments for the applicable accounting period shall specifically include the following, as applicable:

- (a) Net Sales amounts and currency thereof;
- (b) The exchange rate used for conversion into US dollars;
- (c) Quantity of Licensed Products Sold; and
- (d) Any offset amounts claimed by the Licensee.

9.5.2 The Licensee shall keep, at its own expense, accurate books of account, using accepted accounting procedures, detailing all data necessary to calculate and easily audit any payments due the Licensor from the Licensee under this License Agreement.

- 9.5.3 If during any reporting period, no Net Sales are invoiced, billed, or received and no payment is due the Licensor, the Licensee shall nevertheless timely submit a written report to the Licensor stating that no Net Sales were invoiced, billed, or received and no funds are due the Licensor.
- 9.5.4 The Licensor shall have the reasonable right, at its own expense, upon at least fifteen (15) days' written notice, to audit the Licensee's and its Affiliate's books of account to verify compliance with the terms of this License Agreement. The audit may be performed, at any time within three (3) years after the end of the reporting period to which the books of account pertain, by an agent of the Licensor's choice, and shall be performed during normal business hours at the Licensee's place of business or at such other site as may be agreed upon by the Licensor and the Licensee. The agent, at the Licensor's cost, shall have the right to make abstracts or copies of such books of account.
- 9.5.5 Information gained in such an audit and all books of account shall be part of the Confidential Information. However, the Licensor may report, as a bulk amount, the monies received from the Licensee under this License Agreement. The Licensor agrees to impose a similar requirement of confidentiality on any agent appointed by the Licensor to conduct the audit. The Licensor agrees to keep all books of account and audit Confidential Information.
- 9.5.6 If an audit shows that the Licensee has paid more than required under this License Agreement, any excess amounts shall, at the Licensee's option, be promptly credited against future royalties. If an audit shows that the Licensee has paid less than required under this License Agreement, the Licensee shall promptly pay the additional amount due together with interest and late fees as required under this License Agreement for late payments.

ANNEX «B»

RELEVANT TERMS OF AN OPTION AGREEMENT

Subject to the provisions of the present Agreement and payment of the amounts provided for in Annex A□», the Université grants the Company an exclusive option with respect to the rights assigned to the Université by(□) in the Technology which is the object of a Canadian patent application filed (hereinafter: the Apatent»).

The parties hereby set out the steps to be accomplished by the Company in order to sustain its option right granted in the present Agreement. In the case of each step set out, the Company must advise the Université, at the end of each step, of its intention to proceed to the next step or to put an end to the negotiation and to the present Option Agreement, upon failure to send such notice within each prescribed delay, the Company shall be deemed to have put an end to the present Option Agreement.

Step One

The Company shall proceed to a patentability search of the invention of(□). It will have forty-five (45) days from the date of the present Agreement to complete said search. At the expiry of the forty-five (45) day period, the Company shall advise the Université in writing as to whether it wishes to proceed to the second step foreseen below.

Step Two

After the expiry of the last delay set out in section 5 above, the Company may exercise its option to acquire a licence on the technology and the patent in conformity with the terms and conditions stipulated in the Licence Agreement annexed to the present Agreement as Annex A3".

