ROYALTY RATES, WHAT TO FACTOR IN?

LILIANA KOROSI*
ROBIC, LLP
LAWYERS, PATENT AND TRADEMARK AGENTS

One of the first recurring questions asked by intellectual property (IP) licensors and licensees alike concerns the royalty rate (RoR) they would include in their license agreements and what would be the standard RoR in the industry.

Some specialized associations, such as the *Licensing Executives Society (LES)* or the *Licensing Industry Merchandiser's Association (LIMA)*, as well as specialized valuators in the field of IP (such as evaluation divisions of accounting firms) are performing applied analyses in reports and studies on this subject matter, using a pool of license agreements and other information made available to them, and which concern a variety of industries.

An overview of different specialized sources highlighting the RoR† used in **IP license agreements in general**, allowed us to find a possible answer to this question and illustrate it in the list below:

- ENTERTAIMENT INDUSTRY / MEDIA: **12%**
- INTERNET: **12%**
- TRANSPORTATION: **7%**
- PHARMACEUTICAL INDUSTRY: **6-8%**
- EQUIPMENT / COMPONENTS: **6%**
- MACHINERY AND TOOLS: **6%**
- TELECOMMUNICATIONS: **6%**
- CHEMICAL PRODUCTS: **5-6%**
- INDUSTRIAL ENERGY: **5%**
- AUTOMOBILE INDUSTRY: **5%**
- MANUFACTURE/ INDUSTRIAL: **5%**
- INFORMATION TECHNOLOGIES: **5%**
- ELECTRONICS: **4-6%**
- LIFE SCIENCE/ HEALTH: **4-6%**
- FOOD INDUSTRY: **4%**
- CLEAN TECHNOLOGIES: **3%**

*Liliana Korosi is a lawyer for ROBIC, LLP, a firm of lawyers, patent and trademark agents.
† The RoR used in this article is the average or the median flat royalty rate used in general, regardless of the base for its calculation.

In the major fields within the **high-tech sector** (HTS), such as aerospace, software, computers, clean technology, communications, medical devices, semiconductors, consumer products, and electronics, the average RoR in the patent and technology license agreements oscillate between 5% and 6%:

- AEROSPACE: **11.14%**
- CLEAN / GREEN TECH: **3.74%**
- MED & HEALTCARE: **5.25%**
- MANUFACTURE & INDUSTRIAL: **4.34%**
- SOFTWARE: **6.82%**
- SEMICONDUCTOR: **4.38%**
- IT: **4.36%**
- CONSUMER PRODUCTS: **4.46%**
- ELECTRONICS: 4.46%
- TRANSPORTATION: **6.21%**
- NANOTEHC: **4%**

In the **biopharma sector**, the median RoR increases, in general, with the development stage:

- PRECLINICAL: **5%**
- PRE-PROOF OF CONCEPT: **5%**
- POST-PROOF OF CONCEPT: **16%**
- PATENTED / MARKETED: **15%**

As for the RoR used in **trademarks license agreements** specifically, we refer you to the list below:

- APPAREL: **11% (6,5-12%)**
- PHARMACEUTICALS: **5% (4-8%)**
- COSMETICS/ PARFUMS: **7% (5-8%)**
- JEWELLERY: **10% (6-12%)**
- PRESENTS: **8% (6-12%)**
- HOUSEHOLD PRODUCTS/ BEDDING AND LINENS: **8% (5-9,5%)**
- ALCOHOLIC BEVERAGES: **5% (3-8%)**
- NON-ALCOHOLIC BEVERAGES: **4% (3-7%)**

The RoR used in different industries (as an indication only; sometimes difficult to determine in the absence of reliable specialized sources) is one of the **factors to consider** for the purposes of negotiating and determining an RoR which responds to the particularities and the context of each IP license agreement. We have illustrated in the list below, as random examples only, some of these factors which may influence the RoR:

ROBIC, LLP
LAWYERS, PATENT AGENTS AND TRADEMARK AGENTS

ROBIC.COM
INFO@ROBIC.COM

MONTREAL
630 René-Lévesque Boulevard West, 20th floor
Montreal (Québec) Canada H3B 1S6
Tel: 514 987-6242

QUEBEC
2875 Laurier Boulevard, Delta-3 – Suite 700
Quebec (Québec) Canada G1V 2M2
Tel: 418 653-1888

- **Calculation basis for royalties:** The RoR would be higher if calculated based on net sales (the most common calculation basis), compared to the RoR based on gross sales or product costs, or the price per product unit.
- **Exclusivity or non-exclusivity of the license:** An exclusive license would usually trigger a higher RoR.
- **Merchantability:** If the licensee must find a new market or if the IP targets a new market, the RoR would be lower, especially at the beginning of the term, such as to take into account the costs associated with the development of such new market.
- **Market demand:** A higher RoR would be considered if the IP responds to a need, to a specific and important market demand which is not fulfilled otherwise. Market researches and surveys are always recommended before deciding on the IP protection strategy, as well as on the commercialization strategy for the product incorporating it.
- **License agreement term:** A longer term of the license agreement may justify a higher RoR or even a modulated RoR (higher at the beginning, then gradually decreasing, or *vice versa*, depending on the different stages of the product commercialization).
- **Competitive products already on the market:** Additional efforts would be required from the licensee, and the market would be limited, if one or more competitive products are already appreciated on the market targeted by the licensed IP, such that the RoR would be lower.
- **License fee or price**: When the license agreement provides for (i) a licence fee, either in a fixed amount payable with a certain frequency (upon signature, and thereafter, annually, quarterly, etc.), or in a certain percentage out of any other amount received under the licence agreement, or (ii) a lump sum amount payable upon the signature of the agreement, the RoR would be lower.
- **Importance of the licensed IP**: An important impact of the licensed IP on the market or in the industry in general would trigger a higher RoR.
- **Limits as the territory and/or the exploitation field:** A broader territory and/or exploitation field would in principal, trigger a higher RoR.
- **Need to join an additional or adjacent technology**: The RoR will fluctuate proportionally with the percentage represented by the licensed IP in the final product or the access to an alternative IP.
- **Level / stage in the development of the licensed IP**: A higher RoR would be considered if the IP is advanced or ready for commercialization, as the risks and the development costs for the licensee are lower.
- **Objectives or milestones:** Fixed amounts may be attached to each of the important stages or milestones for the development or the commercialization of the product, such as (i) obtaining certain certifications or regulatory approvals (especially regarding patents in the pharmaceutical industry) or (ii) achieving a certain level of net or gross product sales, such as to lower the RoR.

- **Stage of the regulatory approvals and/or of the certification proceedings (especially for patents)**: The RoR would be higher if the regulatory approvals/certification stage is advanced (already obtained regulatory approvals or already issued patents, for example), as the risks (and potentially the costs) for the licensee diminish.

Determining the RoR in a license agreement requires therefore, a complex analysis of the circumstances of each specific situation. An analysis on the importance of the value and potential of the IP, made by a specialized evaluator within the specific industry sector, may be equally useful in certain circumstances. The list of factors mentioned in above is by no means exhaustive, but rather an indication of the factors most frequently analyzed by the parties when negotiating intellectual property licensing agreements.

For any questions or additional information, we invite you to communicate directly with ROBIC's business law team.