

**Part I**

**Term Sheet System  
For a Patent and Know How License**

**With Annotations**

**Hot Topics in IP Licensing: 2009  
Legal and Business Considerations**  
MNCLE Conference Center  
Minneapolis, Minnesota  
May 15, 2009

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## Term Sheet System for a Product Patent License

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This section of the annotated agreement manual includes a full term sheet system with annotations. The information is referred to as a system, because it is a turnkey program for placing binding and nonbinding terms in the context of a license negotiation. Binding terms such as confidentiality obligations with respect to the negotiations are included in a base agreement based upon a familiar and widely acceptable nondisclosure agreement template, while non-binding aspects are placed into a separate attachment. The approach is unique, but gains wide acceptance by those introduced to it.

A. The presentation of annotations for the term sheet system will differ from the presentation of annotations for the license agreement that also is included in this manual.

For the license, the annotations are embedded in context throughout the sample agreement. In contrast, the term sheet annotations are presented up front followed by the term sheet system itself. The term sheet annotations are not embedded in context like the license annotations. The reason for this difference is that the term sheet annotations are much better when presented all at once without interruption. The term sheet system itself is also easier to digest when viewed without the interruption of annotations.

B. Term sheet strategies.

The term sheet offers many advantages. Term sheets can simplify the negotiation process and make it less expensive to place a fully signed license agreement. With a term sheet in hand, the parties can hammer out the main concepts that govern the deal and the agreement structure without getting lost in the clutter of specific details in a full agreement.

A term sheet can be very useful if a deal is complex. Sometimes complexity cannot be avoided. Other times, undue complexity is an artifact of incomplete thinking. Before committing to a complex license structure, spend additional analysis time to see if the same business goals can be achieved with a simpler structure. Often, simplification is possible. Any simplification is desirable, as the drafting, negotiation, administration, operation, and enforcement of the

agreement will be eased. If you have a choice between simple and complex to achieve the same goal, simple simply is better.

The term sheet can also be a useful element of your marketing folio when you are trying to entice another to take or give a license. It often is much easier and more effective to use a term sheet as a discussion guide in talks at these levels than it is to use a full agreement.

Even if the other party has taken the bait and wants to explore a deal, the term sheet can still be useful. The term sheet can be used to test acceptance of certain aspects of the deal at an abstract level before any party commits to specific details. As just one instance of many possible examples of where this can be useful, a term sheet can specify that an initial fee is required without actually specifying the amount of the initial fee. By selling the concept of an initial fee first, the term sheet may catalyze acceptance of the details to come later. Otherwise, setting out the price too soon can be polarizing. Polarization can increase the likelihood that not just the amount of the initial fee, but also the very concept itself, would be unacceptable to the candidate licensee. Opening with a full agreement does not offer similar selling-the-concept-first opportunities, as the full agreement must be full of the details.

A term sheet also can be useful when one of the parties has little experience with licensing. The term sheet can act as a study guide to help the newbie through the agreement drafting, negotiation, and placement process.

A term sheet can also be a great ex parte tool for analyzing a full agreement that has been sent to you by the other side or a colleague. Start your agreement analysis by creating your own "ex parte" term sheet - - one that only you and your client might see. This will allow you to evaluate the essence and architecture of the deal in front of you without obfuscating details. You will know right away whether you need to hammer out concepts or whether you are ready to focus on details. You will be in a better position to assess whether the deal could yield a good return or whether your putative cash cow actually lacks adequate cash and the cow.

Clearly, a term sheet can be a useful tool to facilitate the drafting and negotiation of a license. The term sheet may help you reach a final agreement. Or you may not. If you don't reach a final agreement, you most likely want to walk away from the negotiation without any obligations or liability. This is where term sheets can be dangerous. If you are not careful in how you draft a term sheet, your term sheet can end up being a binding, enforceable contract in unexpected ways. The

proposed license terms that you thought were suggestions can now become obligations for one party and rights for the other. This can be quite a surprise if you intended the term sheet only to be a guide for negotiation and your expectation was that no license would exist until a final agreement were to be signed. Your term sheet must have the right language in it if you are to minimize this risk. Note, though, that not just term sheets but also agreement drafts carry similar risks. So, parties are not necessarily increasing this kind of risk by using a term sheet.

Even if you are careful in how you craft the language of a term sheet, a term sheet can still become a binding, enforceable contract and/or significant liability can accrue if your actual conduct under the term sheet is sloppy or improper. As one common pitfall, one or both parties may start performing under the putative license too soon. Overconfident that the final agreement will be placed, a party may ship supplies to the other party. One party might make royalty payments, and the other accepts those payments. One party might start the transfer of know how, which the other accepts. Even with the most non-binding term sheet language ever crafted, this kind of partial performance by both parties creates a high risk that a contract is in place whose terms are very much unclear. You may wish to walk away from a negotiation without liability or obligation in these circumstances, but your wish may not be granted.

Consequently, you may wish to place an understanding that no express or implied contract is to result from parties that begin to perform too soon. The term sheet system that follows shows one approach for this kind of clause.

Perhaps it is surprising that partial performance under a term sheet forges obligations and liabilities. But it should come as no surprise that misconduct under a term sheet can lead to significant liability. For instance, pirate information that you received in confidence while doing due diligence under the term sheet, and expect to pay the consequences. Ditto if you make fraudulent misrepresentations or other malfeasance or nonfeasance.

Fortunately, there are strategies available to significantly reduce the risk that your term sheet will haunt you with obligations and liabilities according to your worst nightmares:

- Include express language that the proposed license terms are non-binding and that only a fully signed, final agreement will bind the parties.

- Recognize that the term sheet setting will involve some terms that are intended to be binding and then very clearly distinguish between binding and non-binding aspects. These are examples of terms that may be intended to be binding: identifying the parties, establishing confidentiality, excluding third party beneficiaries, prohibiting assignment of the term sheet, setting up a period of exclusive dealing, defining the expiration of the term sheet, making sure the proposed terms of the license are nonbonding until a final deal is signed, setting up a period of due diligence, etc.
- Consider separating binding and non-binding terms into separate documents. For instance, binding terms can be placed in a cover to be signed by both parties. In the meantime, the non-binding, proposed license terms can be placed into an attachment.
- Expressly state that either party may withdraw from the negotiation at any time, including up to and until a final agreement is signed, without the act of withdrawal triggering any obligation or liability to the other. Malfeasance or nonfeasance should be excluded, understanding that withdrawal per se is neither of these.
- Specify a choice of law and venue applicable to construing the binding and non-binding aspects of the term sheet. The risks of term sheets are governed in large part by state law. Since state law can vary, it makes sense to specify the law that supports the strategies you are practicing.
- Recognize that the initially proposed, non-binding license terms will be modified as the negotiation proceeds. The term sheet should expressly state that none of these modifications are to be binding. This is a strategy that is underutilized. Many disclaimers against binding address only the original proposal and do not encompass future evolutions. In the absence of a suitable disclaimer, these future evolutions can be deemed to be binding depending upon the course of dealing between the parties. Avoid terms that the parties wish to be bound by proffered terms, comments, revisions, etc.
- Refer to the non-binding terms as “proposed” or similar.
- Leave out key details, addressing these aspects at a conceptual level. For example, propose that a royalty will be paid, but don’t specify the amount. The amount can be left for negotiation.
- Avoid statements that the final agreement is intended to memorialize the understanding in the term sheet.
- Avoid performing under the final agreement until after the agreement is signed. Don’t jump the gun and start performance before the final agreement is fully signed. You can have perfect,

non-binding language in the term sheet itself, but you can get cooked by starting performance too soon.

- Be aware that many states will imply a duty to negotiate in good faith under a term sheet. Fail to satisfy this duty, and you may incur liability for this malfeasance. Don't enter a term sheet unless you have a good faith intent to negotiate.

The more of these strategies that you practice, the lower is your risk. However, I am not presently aware of any case that sets forth a bright line between binding and non-binding term sheets. There is no formula, if followed, that guarantees that your term sheet will be non-binding. Most of the case law arrives at decisions based upon the totality of circumstances, not by black letter rules. Not only term sheet language, but also party conduct comes into play. This means that term sheet danger can only be reduced, not eliminated.

For additional information, please see Ballard and Lively, "Should You Sue Over A Term Sheet?", The Practical Litigator, pages 43-56 (July 2007), and citing many cases including *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.* 408 F.3d 460 (8<sup>th</sup> Cir. 2005) from the Eighth Circuit.

C. Term Sheet System

NORM CONFIDENTIAL

April 14, 2009

**Confidentiality Agreement between Norman Einstein Technical Institute and Acme**

**Due Diligence and License Negotiation for Rustproof Widgets**

**Effective Date of this Agreement: April 14, 2009**

This agreement is between NORMAN EINSTEIN TECHNICAL INSTITUTE having an office and place of business at One Quantum Plaza, 1023 Avogadros Number Way, Princeton, NJ 08542 (NORM), and ACME CONGLOMERATE as licensee, having an office and place of business at 9876 Avenue of the Widgets, Burbank, CA 91505 (ACME).

NORM owns and controls intellectual property rights, including patent and know how, relating to rustproof widgets. ACME is potentially interested in licensing these rights from NORM. In order to evaluate the intellectual property, NORM wishes to allow ACME to undertake a due diligence evaluation of the intellectual property rights. Additionally, the parties may wish to negotiate and place a corresponding license. These negotiations might involve discussions and exchanges of written correspondence including exchanges of one or more term sheets, one or more draft agreements, revisions and comments relating to these drafts, and the like. The parties wish to protect the confidential and proprietary nature of the information that might be exchanged in the course of the due diligence and negotiations (collectively referred to herein as the "Project"). Also, the parties do not wish to be bound by any express or implied agreement terms or to have given or received any rights or obligations relating to the Purpose unless and until a final agreement is signed by an authorized official of both parties ("Final Agreement"). Accordingly, ACME and NORM, INC. agree that:

1. In the course of the Project, one party (the Disclosing Party), in its respective discretion, may choose to share its Confidential Information (defined below) with the other party (the Recipient) with the understanding that the other party will only use the shared information in connection with the Project and for no other purpose. By receipt of information from NORM in the course of carrying out due diligence of the NORM intellectual property rights, ACME acknowledges that it has a common interest with NORM with respect to the information for purposes of protecting privilege. If ACME does not have this common interest with any information, ACME shall promptly return or not accept such information.

2. The Disclosers of Confidential Information under this Agreement are both parties. The parties' representatives for coordinating the exchange of Confidential Information include:

NORM: Enrico Fermi and Erwin Shrodinger

ACME: Michael Faraday and Marie Curie

or other(s) that each party may respectively designate in writing from time to time.

3. ACME shall be entitled to conduct a due diligence of the NORM intellectual property relating to rustproof widgets during the period extending from April 14, 2009, through June 30, 2009. NORM shall have the discretion to choose the NORM Confidential Information that NORM will share with ACME as part of this due diligence. The period of negotiation shall extend until December 31, 2009, unless extended in writing by both parties.
4. During the course of the Project, the parties may exchange one or more term sheet(s) and/or one or more draft licenses that contain possible terms and conditions that might be incorporated into a Final Agreement. The parties may also exchange information relating to possible terms and conditions for such a Final Agreement, including but not limited to comments, revisions, modifications, and/or the like relating to such term sheet(s) and/or draft licenses. The parties agree that any and all of such information is for discussion purposes only and shall be non-binding. This information is intended only to provide a foundation for the parties to discuss terms and conditions that could be the basis for a Final Agreement, if any. Neither party has any obligation to enter into any agreement with the other for any reason. Only a written, fully signed agreement is to be binding upon the parties. With this understanding in mind, an initial term sheet proposing possible terms and conditions that could be incorporated into a potential Final Agreement is attached hereto as **Exhibit A**.
5. Both parties understand and accept the risk that no Final Agreement may be reached and that either party, in its sole discretion, may withdraw from these negotiations at any time without incurring any liability to the other based upon such withdrawal. Either party may withdraw in this fashion even if a party unilaterally or in cooperation with the other has performed acts prior to reaching a Final Agreement that could be considered to be a performance under a potential Final Agreement or other understanding between the parties relating to the NORM intellectual property rights. Neither party shall be entitled to rely upon any such performance as a basis to assert that an agreement or other understanding exists between the parties that grants any rights or obligations under the NORM intellectual property rights.
6. "Confidential Information" means all business, legal, and technical information, including drawings, processes, business plans, patent or other legal information, customers, finances, formulations, recipes, designs, concepts, flow charts, relationships with third parties, specifications, material, goods, software, equipment, components, and the like of the Disclosing Party. The existence and content of this Agreement also shall be considered Confidential Information.



7. This Agreement controls only Confidential Information that is disclosed from the Effective Date through December 31, 2009. This Agreement shall be terminable without cause by either party upon ten (10) days advance written notice given to the other party; however, the obligations of this Agreement, including but not limited to those relating to confidentiality, non-use, non-binding character of information and acts, and notice that accrued prior to termination or expiration shall survive termination or expiration.
8. The Recipient receiving Confidential Information under this Agreement may use the Confidential Information only during the term of this Agreement only in connection with the Project. This restriction on use of the other party's Confidential Information shall survive termination or expiration of this Agreement.
9. Recipient shall not disclose Confidential Information to any third party, individual, proprietorship, partnership, corporation, or other entity without the prior written consent of the Discloser. Recipient also shall limit its disclosure to only those of its employees, legal advisers, and financial advisers having a need to know the other party's Confidential Information in connection with the Project. Recipient shall protect the disclosed Confidential Information by using at least the same degree of care as the Recipient uses to protect its own confidential information of a like nature, but no less than a reasonable degree of care. Recipient agrees to immediately notify the Discloser in writing of any actual or suspected misuse, misappropriation or unauthorized disclosure of Confidential Information of the Discloser that may come to the Recipient's attention.
10. In the course of discussions between the parties, NORM may choose to provide ACME with access to, or copies of, legal files of NORM, including intellectual property files solely for ACME to evaluate these files in accordance with the Project. If NORM provides ACME with any such copies, ACME represents and warrants that it shall not make any additional copies of the files, whether hard copies or electronic copies, without the express written permission of NORM.
11. Disclosure of Confidential Information by the Recipient shall not be precluded if such disclosure is in response to a valid order of a court or other governmental body of the United States or any political subdivision thereof; provided, however, that Recipient shall first have given written notice of such request to the Discloser as promptly as possible and shall also have given Discloser the opportunity to oppose the disclosure and/or obtain a protective order which provides that the Confidential Information so disclosed be used only on a confidential basis for the purposes for which the order was issued.
12. Upon the written request of the Discloser, Recipient shall promptly return to Discloser or destroy, as appropriate, all tangible Confidential Information of Discloser; provided, however, that all physical copies of legal files provided to ACME or its legal counsel must be returned to NORM, or deleted from electronic files if provided electronically, within 30 days of ACME's receipt. An authorized representative of Recipient shall certify compliance with this paragraph.

13. A Recipient shall have a duty to protect only that Confidential Information which is (a) disclosed by the Discloser in writing and is marked as confidential, proprietary, or with a similar legend, at the time of disclosure or (b) which a reasonable person would conclude, is intended to remain confidential, due to its nature or the circumstances under which it is disclosed, or (c) which is disclosed in any manner by Discloser and is identified as confidential or proprietary at the time of the disclosure and Discloser summarizes the Confidential Information in a writing provided to the Recipient within thirty (30) days.
14. The obligations herein to protect Confidential Information against disclosure to others will not apply to any Confidential Information which is (a) available to the public other than by breach of this Agreement by Recipient or the breach of a confidentiality or fiduciary duty of another; (b) rightfully received by Recipient from a third party without a confidential obligation or limitation; (c) independently developed by Recipient without any use of the Discloser's Confidential Information and by Recipient's employees who did not have access to Discloser's Confidential Information, as demonstrated by files created at the time of such independent development; (d) known to Recipient, without restriction, at the time of disclosure, as demonstrated by files in existence at the time of disclosure.
15. Each Discloser warrants that it has the right to make the disclosures under this Agreement.
16. Except as may be otherwise provided in another written agreement entered into by the parties, neither party acquires any intellectual property rights, express or implied, of the other party under this Agreement or as a consequence of the expiration or termination of this Agreement except the limited right to use with respect to the Project. All Confidential Information, including all intellectual property thereto, shall remain the property of the Discloser.
17. Neither party has an obligation under this Agreement to purchase any service or item from the other party or to enter into any agreement or understanding with the other party. Neither party has offered for sale products or services, or has an obligation under this Agreement to offer for sale products or services, using or incorporating Confidential Information.
18. Neither party shall originate any publications, advertising, sales promotion, news release, or other public announcement, written or oral, relating to this Agreement or the relationship between the parties without the prior written approval of the other party, except as otherwise required by law.
19. A Recipient shall adhere to the U.S. Export Administration laws and shall not export or re-export any Confidential Information received or any technical data or product made using such Confidential Information, to any country prohibited from obtaining such data or product by the U.S. Department of Commerce Export Administration regulations without first obtaining a validated export license.
20. The parties do not intend that any agency or partnership relationship or other formal business relations or association be created between them by this Agreement.

21. This Agreement is not assignable without the prior written consent of the non-assigning party. Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.
22. This Agreement is made under and shall be construed according to the laws of the State of Minnesota. Venue for any dispute relating to this Agreement shall be in Hennepin County, State of Minnesota.
23. This Agreement states the entire agreement of the parties as to the Project.
24. All additions or modifications to this Agreement must be made in writing and must be signed by both parties. Discloser's waiver of or failure to enforce any term of this Agreement, or any similar agreement, as to a specific act or circumstance at any time shall not constitute a waiver as to any other act or circumstance. If one or more provisions of this Agreement are held to be unenforceable under applicable law, the parties agree to renegotiate such provision in good faith. In the event that the parties cannot reach a mutually agreeable and enforceable replacement for such provision, then (a) such provision shall be excluded from this Agreement, (b) the balance of the Agreement shall be interpreted as if such provision were so excluded and (c) the balance of the Agreement shall be enforceable in accordance with its terms.
25. Recipient shall not analyze or have a third party analyze any tangible embodiments of Confidential Information of the other unless expressly authorized herein, and all results of any such authorized analysis shall be considered Confidential Information for purposes of this Agreement.

AGREED TO AND ACCEPTED:

**Norman Einstein Technical Institute**

**Acme Conglomerate:**

\_\_\_\_\_  
(Authorized Signature)

\_\_\_\_\_  
(Authorized Signature)

\_\_\_\_\_  
(Printed Name)

\_\_\_\_\_  
(Printed Name)

\_\_\_\_\_  
(Title)

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(Title)

#52250

# EXHIBIT A

## PROPOSED NON-BINDING WORKSHEET INCLUDING SUGGESTED TERMS THAT COULD BE ALL OR A PART OF A BASIS FOR A POSSIBLE LICENSE AGREEMENT BETWEEN NORM AND ACME

**IMPORTANT:** *This document, any revisions thereof, any draft licenses derived from this document or a revision thereof, and any modifications and comments of any of these are for discussion purposes only and are non-binding. This information is intended only to provide a foundation for the parties to discuss the terms and conditions upon which a written, fully signed license agreement, if any, would be entered into by NORM as a licensor and ACME as licensee. Neither party has any obligation to enter any such Final Agreement with the other based upon this Worksheet or discussions relating to this Worksheet. Per the Agreement to which this Exhibit is attached, only a fully signed, written agreement is to be binding among the parties.*

### Parties

Licensor **Norman Einstein Technical Institute**  
Licensor Address One Quantum Plaza  
1023 Avogadros Number Way  
Princeton, NJ 08542

Licensee **ACME Conglomerate**  
Licensee Address 5500 Acme Plaza  
9876 Avenue of the Widgets  
Burbank, CA 91505

Licensee Business Form: Corporation

State of incorporation: Delaware

### Trial Period

There will be a 90 day trial period beginning on the effective date of a license agreement entered into between NORM and ACME. At any time during the trial period, ACME has the right to accept or reject the license.

The license agreement will automatically terminate at the end of the trial period unless ACME accepts the license agreement by providing written notice to NORM before the end of the trial period.

Royalties and the upfront fee will be deferred during the trial period. The upfront fee and any royalties earned during the trial period will become due upon acceptance of the license agreement. No royalties or initial fee shall be payable if ACME rejects the license. The upfront fee is creditable toward all royalties including those earned during the trial period.

As consideration for NORM providing ACME with the trial period, ACME will provide NORM with 10% of the envelope samples prepared in each test run. Additionally, ACME will share testing data with NORM.

### **Intellectual Property Definition**

Patent and know how rights relating to NORM rustproof widgets, components of these, repair parts, and assemblies that include such widgets as a component. Know how can only be used during agreement term

Patent protection is pending and additional patent rights are being pursued. These patent rights will remain the property of NORM.

### **Licensed Products Definition**

Industry: No limit

Product: Rustproof widgets incorporating NORM patent and know how rights.

### **Territory**

United States, Canada, and Mexico

### **Rights Granted**

- nonexclusive
- sell
- offer for sale
- make
- make for others
- distribute
- use
- advertise
- promote

### **Compensation**

Initial fee due at signing, creditable towards royalty

Royalty as a percentage of net sales due on shipment

Minimum annual royalty

### **Rights Reserved**

Licensor reserves the rights other than those being expressly conveyed or granted in this Agreement.

**Term**

Subject to trial period, fixed 5-year term with renewals

Up to 5 one-year renewal periods subject to compliance and milestones.

**Termination**

NORM can terminate for breach. ACME shall have a cure period of 30 days from notice of any such breach

**Provisions Protecting Confidential Information**

Confidential provisions protecting the parties respective Confidential Information (encompassing both business and technical information) shall be included.

**Audit Rights**

NORM shall have the right to audit the records upon which royalty reports and any payments are based.

**Assignment**

ACME has no right to assign or otherwise convey this agreement to any third party without the written consent of NORM.