

## Negotiating Milestone Payments in Light of Force Majeure Events

With a worldwide pandemic, a gyrating economy, an erratic stock market, turmoil in many of America's largest cities and a high-stakes election, 2020 has been a tumultuous year. Apart from the obvious anxieties they cause, the aftershocks of such events may trigger force majeure clauses in joint-development agreements and licensing agreements.

To what extent should licensees compensate licensors who terminate licensing agreements based on instances of force majeure?

### One Scenario

Suppose that an agreement was struck between a licensee and a licensor. As part of this agreement, the licensee promised to pay the licensor \$1 million if a major technical milestone was reached. The licensee wanted to keep the licensor on a short leash. So, the licensee and licensor set out five markers (mini-milestones) that the licensee would be expected to meet along the way to achieving its million-dollar milestone. Both parties agreed that the probability of meeting any of these mini-milestones was 50%.

The licensee made another commitment to the licensor: If the licensee decided to exercise its termination rights based on an act of force majeure, the licensee would "fairly compensate" the licensor for its progress towards meeting its million-dollar milestone. Both sides believed they had an equitable agreement and the licensor went about its work to achieve the stipulated technical goals.

Six months after signing their joint-development or licensing agreement, the licensor met the first three markers. Then an act of force majeure occurred. Perhaps a war erupted or an earthquake demolished the licensee's production facilities. A new pandemic could have pervaded the globe. GDP or the stock market could have plunged below defined thresholds. Alternatively, the licensee could have been the target of a strike or cybercrime. Whatever the specific act of force majeure, the licensee decides to exercise its option to terminate its agreement with the licensor.

The question becomes, "What percent of the \$1 million potential milestone payment (if any) does the licensor deserve?"

### Coming to Agreement

It is conceivable that the two sides would take aggressive positions on this issue. The licensor may claim that it is entitled to the entire million dollars, perhaps because it disputes that an act of force majeure actually occurred. Such dispute may revolve around the definition of force majeure. On the other hand, the licensee could argue that it does not have to pay the licensor anything because the major milestone should have been met within six months and the fact that this did not happen indicates that the licensor would never be able to overcome the technical challenges.

Both parties would like to resolve the milestone payment amicably, as our licensee and licensor have an accretive business relationship that extends far beyond this particular agreement. Splitting the

difference, at least as an opening offer, may be a non-contentious means to achieving resolution. Or, the licensor may offer to accept just \$600,000. The licensor would believe that this is a very fair offer as it represents 60% of the markers that it achieved (that is, three out of the five markers) and is 40% discount from the licensee's exposure.

However, the licensee may have a different idea about calculating an equitable payment. The licensee may offer \$250,000. The logic would be that the probability of the licensor meeting its major milestone from where it now stands is 25%. This 25% reflects that the licensor has two more mini-milestones to meet and the probability of meeting each one is 50%. (Thus, the combined probability of the licensor achieving its next two mini-milestones is 25% (50% x 50%).)

### **In Conclusion**

Many licensing negotiators may not want to bring up the calculation of milestone payments in light of force majeure events. Why? Because the likelihood of this scenario occurring is, by definition, slim. Negotiators simply do not have time to negotiate the intricacies of every conceivable contingency. Probing too many esoteric issues can jeopardize consummating the overarching agreement.

However, if an event of force majeure were to occur there is more than one way to calculate an equitable milestone payment. Now, licensees can select a resolution that is fair to both sides and that reduces their liability.

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