

The timing of a license agreement can help move a faculty member out of the CEO role, noted **Colm Lawler**, senior licensing manager at Boston Children's Hospital. In one real-life case, he said, a start-up led by a researcher knew they needed a CEO, and to push that forward Lawler used a simple option agreement rather than executing a license with the start-up. Finding a CEO required as part of the development plan before a license would be offered.

It was an idea that resonated with **Becky Stoughton** of consulting firm Fuentek, LLC, who noted that Rice University uses a similar option agreement with a CEO milestone required before license. "Too many times the licenses are done prematurely," she observed, suggesting that universities adopt policies regarding licensee readiness. "The license doesn't have to come first," she said.

- In a session on monetizing more patents that might seem dormant by taking infringement action, **Nicholas Matich** with law firm McKool Smith noted that TTOs could assert more patents by keeping more patent applications open. By examining the applications later alongside information on potential infringers and competitors, the patents can be revisited and strengthened with claims to make them "litigation grade," he said. And how long should TTOs support patents that don't get licensed and don't make that grade? **Theresa Schultz** at UT-Arlington says she will "pay the first maintenance fee, take a hard look at the second, and probably won't pay the third." **Sandra Brown** with RPI suggests with low-potential assets keeping the U.S. patent active but dropping any foreign applications "because those annuities really add up."

- In a session on office restructuring, Cornell's **Alice Li** reported that the TTO's recent shift away from a cradle-to-grave structure for licensing staff had a well-timed secondary effect on staff recruitment -- a major concern for most offices of late. "It made it easier to recruit" licensing staff, she said, since a more focused, vertical role means you don't have to find the rare generalist who can do it all.

- Don't get too upset when your researchers criticize your office -- it could always be worse. At the University of Malta, on a small island nation and with a small but active tech transfer operation, **Andras Havasi**, manager of corporate research and knowledge transfer, is working diligently to boost the office's outreach and get more involvement from faculty. He conducted a survey of researchers as part

of his efforts aimed at brand building and changing perceptions since the office was generally seen as "just the patent guys." One comment stuck with him, and even motivated him to work harder toward that change. He recounted it for the audience word-for-word: "The university has the same will to innovate as a donkey's will to climb a tree." Ouch.

Look for more coverage from the AUTM annual meeting in future issues of Technology Transfer Tactics. ►

Guest Commentary

Is My Licensee in Compliance? Tips to Keep Them on Track

By Debora (Stewart) Rose, CPA, and Kris Anton, CPA
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This article is based on a handout given by InvotexIP to attendees of a session on royalty audits last month at the AUTM Annual Meeting in Austin, TX. It has been edited from the original, with permission.

University TTOs spend significant time and money negotiating the terms of their license agreement, but what happens once the ink is dry and it's business as usual? Is anyone checking to ensure compliance with the meticulously negotiated contract?

Licensors, including universities, often tend to be hesitant in initiating a proactive compliance program. This is due to an outdated perception that engaging with the licensee is an accusation as opposed to an effective tool to open lines of communication and assure that all parties are on the same page. A strong compliance program is conducted with respect for the licensor-licensee relationship.

Since we began aggregating royalty audit data 25 years ago, we have found that approximately 87% of licensees underpay royalties to their licensors, frequently by staggering amounts. (See **Figure 1 on page 41**.) Why do these underpayments occur? While there are rare cases of intentional misreporting, our experience shows that it is most often due to human error.

Start off on the right foot

Here are some simple ways to keep an eye on what’s going on to give yourself a better probability of compliance, starting at license inception.

In most cases the people responsible for tracking, calculating, and paying royalties due are completely different from the people who negotiated the license. In fact, we often find that the people calculating the royalties due have never even read the agreement. A good way to mitigate this is to establish a relationship with the person in the licensee’s organization who will be responsible for the administration of the license. We recommend sending that individual a Welcome Package that includes the following:

- A copy of the agreement;
- Contact information for someone in your organization who can answer questions;
- A royalty report template in Excel if you don’t have a company reporting portal, along with instructions for sending the report;
- Payment instructions;
- Interest calculation for late payments;
- A letter explaining compliance practices that include routine royalty audits.

Providing this Licensee Welcome Package is an

excellent first step in establishing a relationship built on trust and transparency. It encourages direct communication and establishes the expectation that you are paying attention to all of your licensees. It also sets up future inquiries or notification of a royalty audit as a routine best practice and not an accusation of wrongdoing.

Annual outreach

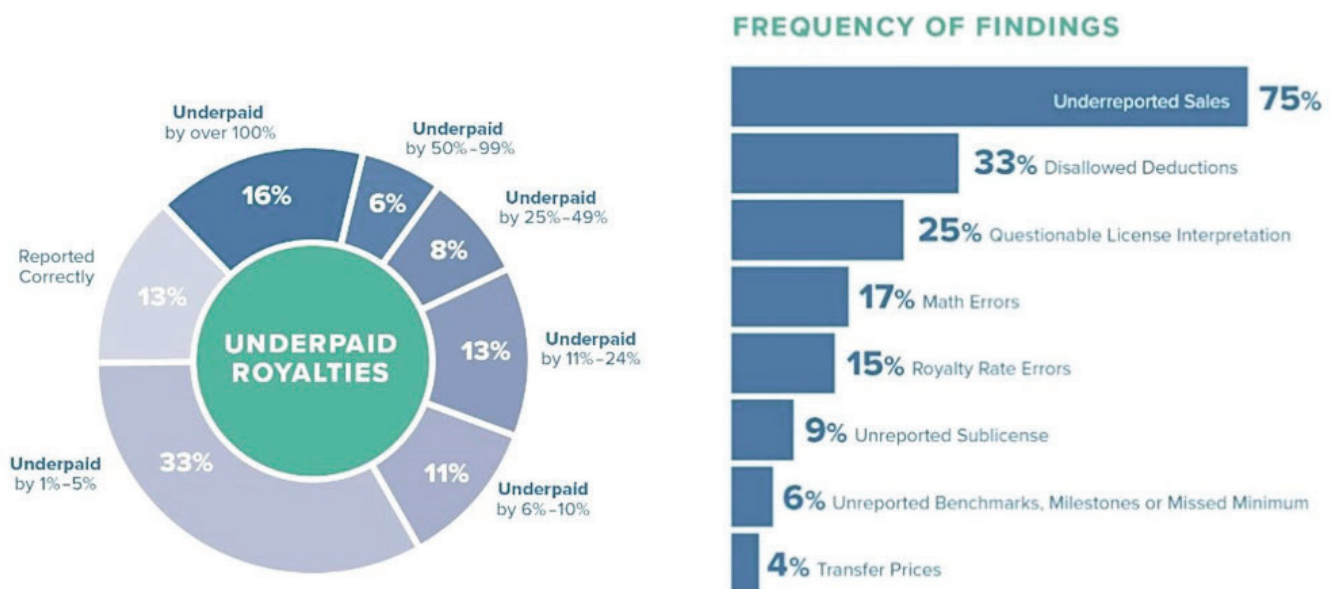
Each year, we recommend sending a letter to every licensee explaining any changes that occurred in the past year and providing a status update on your compliance practices. Include a reminder that you may reach out with questions and that you routinely initiate third party royalty audits. Request each licensee perform the following tasks and fill out a standard survey to summarize:

- Results from the performance of a self-audit.
- Any royalty true-up due after recalculating royalties to include any end of year adjustments.
- Outcome from the recalculation of guaranteed minimums and milestone payments.
- Any difficulties in the royalty calculation process.

Ask your licensee to list any additions or significant changes in the SKUs of licensed products, product categories, sales channels, or territories. Ask for an updated list of all sublicensees, affili-

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Figure 1



Source: Invotex Audit Statistics, 1997-2022

Compliance *continued from p. 41*

ates and distributors. This is also a great time to ensure that you have copies of all sublicenses and other agreements to which you are entitled. Inquire about any potential new licensed products in the pipeline.

You may be pleasantly surprised to receive a check from a licensor for a spontaneous correction of a royalty underpayment as a result of this annual inquiry.

Ongoing compliance checks

Ongoing royalty compliance checks, at the very least, should include having someone perform a cursory review of every royalty report and payment received. Perform a high-level check that the royalty report data appears correct and that no math errors are apparent. Confirm that guaranteed minimum royalties are being met. Match the cash received to the royalty report received. Reach out to your contact at the licensee with any questions on a routine basis.

It is a great idea to also perform a general analysis of the data provided. Some simple items to check:

- Confirm the correct royalty rate is applied.
- Review deduction categories and confirm allowance under the license agreement.
- Compare royalty reports from quarter to quarter and identify inconsistencies.
- Confirm cash payments were received by the due dates. If they were not, calculate applicable interest and bill the licensee.
- Check that all required information on the royalty template is being provided by the licensee.

Potential triggers for 3rd party audit

It may seem daunting to evaluate your license portfolio for royalty audit candidates, but here are some potential audit triggers to help jumpstart your analysis.

Basic Metrics

- License generates \$100,000 or more in annual royalties.
- Trend analysis of royalty reports is not consistent with expectations.
- Licensee reported a correction of a prior over- or underreporting.
- Licensee is slow to answer questions and does not provide consistent royalty calculations.

- Royalty reporting process seems overly manual and therefore subject to human error.
- Royalty reports are not transparent in presenting information regarding the licensed products sold and the royalty calculation.

- Licensee sells a lot of customized products.
- New SKUs are added often.

Unique Scenarios

- Agreement expired or will expire soon (sell off issues may need to be resolved).
- New licensed products/brands have been added (by an amendment or verbal/email agreement).
- Licensee had a change in business structure such as an acquisition or merger.
- There has been turnover at licensee, those who originally negotiated the license and prepare the royalty report are no longer there.
- Licensee is consistently reporting sales very close to the guaranteed minimum.

Issues with Net Sales (Royalty Base) Definition

- Has limited deductions.
- Disallows deductions that are commonly allowed under GAAP (for example Group Purchasing Organizations fees or co-marketing spend to customers/distributors).
- Allows for allocation of Net Sales for combination products or bundling.

Complicated Royalty Due Calculation

- Royalty rates are different by product/distribution channel/territory.
- There is a deduction % limit.
- Deductions are defined as the lower of an allowed % or actual.
- More than one guaranteed minimum royalty calculation.
- Deduction allowed for royalty stacking (\$ or royalty rate reduction).

No downside to royalty monitoring

Remember, 87% of licensees underpay royalties. It is your fiduciary responsibility to make sure yours are reported and paid correctly. A well-designed compliance program only strengthens the licensor-licensee relationship and sets the stage for mutual success.

Editor's note: InvotexIP is a royalty audit firm led by Debora (Stewart) Rose, CPA, and Kris Anton, CPA. The firm's practice philosophy is one of polite persistence. Invotex is known for its ability to uncover large underpayments while relationships are preserved. Contact (Stewart) Rose at 443-821-0191 or dstewart@invotexip.com; contact Anton at 443-821-0196 or kanton@invotexip.com. ►