

## How to Stop Worrying & Start Implementing License Agreement Compliance

Welcoming remarks will begin at  
11:55 a.m. Eastern Time.

The formal presentation will begin at Noon Eastern

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## Speaking with you today



**Hassan R. Naqvi, Center for Technology Transfer and Commercialization, Vanderbilt University**

Hassan oversees license compliance at Vanderbilt University's Center for Technology Transfer and Commercialization (CTTC) and has over 5 years of experience in initiating and managing license agreement compliance programs. Hassan is a member of AUTM and part of the of the AUTM Annual Meeting Program Committee and also serves on the BIO Translational Research Forum Program Committee for the 2014 BIO International Convention.



**Nate Ruey, McGladrey Royalty Advisory Services**

Nate is a Certified Public Accountant, Certified in Financial Forensics and a Certified Internal Auditor. Nate has over 10 years of professional experience and specializes in conducting royalty investigations for universities and other public and private institutions, including reviews in the following industries: life sciences, medical supplies, medical devices, agriculture, publications, industrial products, and consumer products. As a member of the Association of University Technology Managers, Nate is a committee member for the Licensing Activity Survey publication.

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**Questions?**

**We will be taking questions at the  
conclusion of the presentation.**

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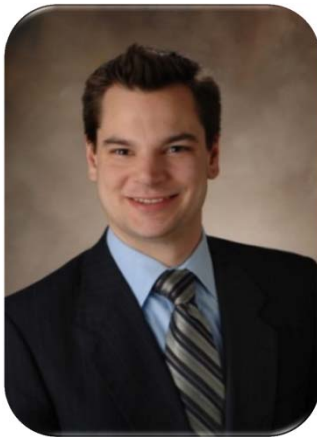


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**Nathaniel Ruey, CPA**  
Director

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Licensing Officer

Vanderbilt University

## How to Stop Worrying and Start Implementing License Compliance

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McGladrey LLP



August 27, 2013



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## Overview

- Introduction – Why Focus on Compliance?
- Compliance Functions
- Running an Effective Compliance Program:
  - Initiating
  - Maintaining
  - Excelling
- Licensee audits as a tool for ensuring compliance
- Wrap-up and Conclusions

## Poll: Who is responsible for monitoring licensees for compliance at your university?

- We have a specific compliance function in our office.
- The licensing managers are responsible for compliance of licenses in their portfolio.
- What's compliance???

## So, Why Bother With Compliance?

- Living with the License
  - A license is a partnership
    - Average term of 15 years
    - Team effort
      - need for constant communication
  - A number of promises made
  - Are both parties still on the same page?
    - Intent vs. contract language
    - Expectations vs. realities



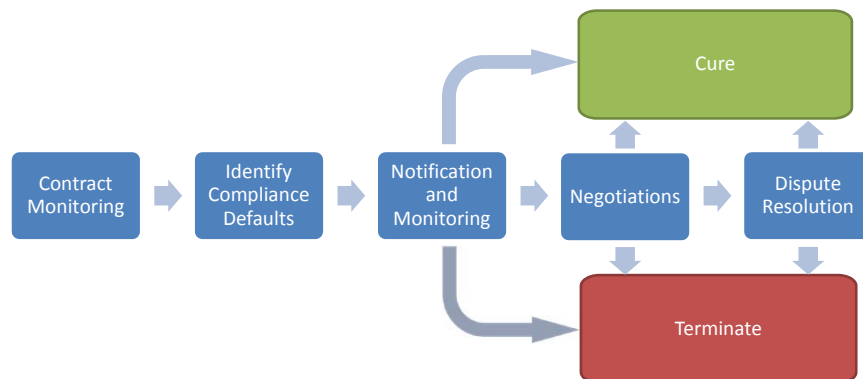
## Compliance Functions



- Ensure that:
  - Correct royalties are paid
  - Diligence and development progress assessed
  - Patent expenses reimbursed
  - Covenants and warranties honored
  - Delinquencies confirmed
- Internal reporting and feedback
  - Performance metrics for active licenses
  - Provide feedback on licensing language

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## Compliance Process



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## Poll: How are license agreements and associated records maintained at your TLO?

Choose all that apply.

- Physical files and paper records kept in a file cabinet
- Database
- Licensing managers keep their own records
- Other

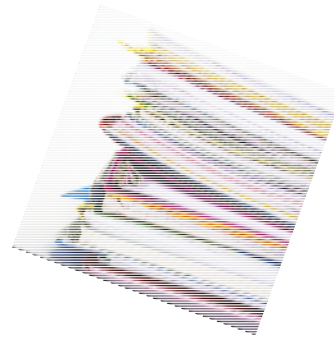
## Initiating a License Agreement Compliance Program

- Assemble the right team for compliance
- Preliminary review of active license agreements
  - Sources of information:
    - Database
    - Hard files
    - Licensing manager
- Initiate and maintain a running list of compliance issues
  - Prioritize by nature of delinquency
  - Focus on financial delinquencies
- Consult with the Licensing Manager
- Reach out to companies



## Maintaining License Agreement Compliance

- Automate the process
  - Docket license terms
  - Generate automated messages
- Setup an Internal Monitoring mechanism



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## Internal Monitoring Considerations

### Do You Have???

- A royalty reporting template
- A calendar for each License Agreement to manage key dates
- Standard operating procedures
- An abstract of the key terms and conditions of the license agreement
- A royalty payment trend analysis for each Agreement

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## Royalty Report Template Suggestions

At a minimum, the following information should be included and detailed by country of sales origin:

- Product number
- Units sold
- Unit price
- Each deduction by category to arrive at net sales
- Royalty rate
- Foreign currency conversion rate, if applicable



### Royalty Report

Company Name: \_\_\_\_\_

Country of Sales	Seller	Product name or Catalog number	Patent(s)/ Application(s) covering product	Number of units sold	Total Quarterly Gross Sales	Selling Entities	Less Allowable Deductions	Net Sales	Royalty Rate	Other Income (including sublicense revenue)	Total Due
USA											
Canada											
Europe:											
Japan											
Other:											
Total:											

Currency reported: US Dollar Other (Specify): \_\_\_\_\_

Total Royalty in US Dollars: \_\_\_\_\_ Conversion Rate used (if applicable): \_\_\_\_\_

## Internal Monitoring Considerations, *continued*

- Monthly or quarterly internal meetings to discuss your active licensee portfolio
- Tracking the patent or agreement expiration date
- A process to conduct periodic internal or external audits
- An open relationship with licensee – this is a partnership, don't be afraid to call them with questions

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## Excelling at License Agreement Compliance

- Work with licensees...
  - Standardized reporting
  - Regular updates
- ... and the Licensing Manager
  - Compliance is a team effort
  - Help LM maintain relationships with Licensee
- Explore other options for increasing compliance
  - Collections
  - Payment plans
- Provide feedback to construct a better license
  - Interest on late payments
  - Breach and terminations
  - Net Sales definition
  - Audit rights



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## License Agreement Language Suggestions

- Net Sales definition
- Include late payment and interest fees
- Right to audit at least annually
- Books and records should be maintained based on statute of limitations
- Methodology errors
- If audit identified underreported royalties in any reporting period over x%, cost of audit should shift to licensee
- Do not need to include that an audit is conducted by an independent CPA

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## Other Useful Language

### 1.1 Financial Projections

To assist the Licensor in projecting its future revenues, Company shall provide the Licensor with a five-year projection of Net Sales of Licensed Product within six (6) months of the Effective Date. Such projection shall be updated by Company annually, the first update due at the end of the calendar year containing the first anniversary date of the Effective Date. The Licensor acknowledges that such projections are speculative, and that Company shall have no liability for the Licensor's reliance on same. The Licensor agrees that such projections will be considered Confidential Information, and shall be subject to the confidentiality provisions contained herein.

### 1.2 Diligence Reporting

Throughout the course of commercial development of Licensed Products by Company, its Affiliates and Sublicensees, Company shall provide the Licensor with reasonably detailed confidential periodic summary reports evidencing its efforts in, progress made, and future plans for, its development of Licensed Products, on a Licensed Product-by-Licensed Product basis, and bringing same to market (such reports to be provided no less frequently than every six months, the first report to be due within 12 months after the Effective Date). In addition, Company shall provide to the Licensor commercially reasonable evidence of Company having achieved each of the above-defined commercial Milestones within thirty (30) days after the corresponding Milestone Date set forth above.

### 1.3 Product Reports

In addition to the foregoing reports, Company shall deliver annually a report containing Company's financial statements for the preceding twelve (12) months including, at a minimum, a balance sheet and an operating statement. Such reports shall be considered Confidential Information, and shall be subject to the confidentiality provisions contained herein.



## Poll: Have you ever conducted an internal royalty audit of any of your licensees?

- Yes
- No

## Why Universities Conduct Royalty Audits

### Reactive

- Royalty payments received are getting smaller or stop coming in
- Payments received are late
- University has information that the licensee is either underreporting licensed product sales or is selling new products containing the licensed technology

### Proactive

- Fiduciary responsibility to university stakeholders
- University has developed a Royalty Audit Plan
- Induce future compliance



## Poll: When was the last time you audited one of your licensees?

- Within the last year
- Within the last 1-3 years
- Over 3 years
- Never conducted a royalty audit

## Example Royalty Audit Plan Approach – Tiered License Agreements

- Determine the median royalty revenue of each License Agreement in your portfolio
- Divide the portfolio into thirds
- Assuming top third of your License Agreements generate royalties in excess of \$200,000 each annually, these licensees should be randomly audited at least once within their Agreement required recordkeeping term
- If possible (budget), randomly select a licensee from the middle or bottom third for audit

## Example Royalty Audit Plan Approach – Risk Based

- Each License Agreement is structured differently and, based on the licensed technology and licensor, different risk factors exist
- Example risk factors include:
  - International manufacturing and sales
  - Agreement complexity
  - Number of other parties involved:
    - Sub-licensees
    - Distributors
    - Affiliates
  - Start-Ups



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## Common Errors Uncovered During a Royalty Audit

- Deductions from sales subject to royalty, not allowed
- New products containing the licensed technology, not reported
- Cell formula errors in manual Excel spreadsheets
- Underreporting by foreign subsidiaries
- Inconsistent interpretation by domestic and foreign-related entities
- Understanding IP Law

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## Royalty Audit Recovery Rates

### Audit Statistics:

- 75%-80% of our audits determine underpaid royalties
- 95% + of the 75%-80%, produce recoveries in excess of the cost of the audit



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## Lessons Learned

- Licensee compliance begins at negotiation
  - Licensing language issues
    - Clarify intent in agreement
    - Clearly enunciate obligations and due dates
    - Uniform reporting format
- Compliance is a team sport
- Automate compliance functions as much as possible
- Explore other options to ensure compliance
- Use your compliance experience to help build a better license agreement template

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## Contact Information

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## Questions? Comments?



# Discussion and Q&A

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Negotiation of License Agreements  
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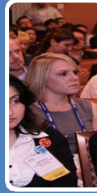
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