

Post-Contract Monitoring

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Overview

- Why post-contract monitoring matters
- Key provisions to monitor
- Setting up a monitoring program
- Using audits
- Dealing with noncompliance
- Drafting to enhance compliance

Why is it important?

- Assuring the technology is being developed
 - Licensed technology may become a “blocking strategy” over time
 - Used to help keep competitors from developing a competing technology
 - Sublicensing play exclusively
 - Not necessarily in the interests of licensor
 - We have an obligation to develop the technology so the public can benefit from government funded research

Why is it important?

- Assuring that all users are licensed
 - Infringement deprives inventors and research organizations of royalties
 - Actual licensees of the technology are at a competitive disadvantage
 - Paying royalties on net sales while their competitors are not
- Determining if royalties are overdue

Why is it important?

- Determining if royalties have been properly paid
 - Even if paid on time, licensees may underpay or overpay royalties
 - Confusing license language regarding royalties
 - Misunderstandings about licensed products
 - Poor reporting and accounting practices
 - Greed

Why is it important?

- Assuring all licensees are treated fairly
 - Infringement
 - Changes in scope of patent claims during prosecution
 - Royalty overpayment
 - Regulatory requirements
 - Changes in patent and contract law

Key Provisions to Monitor

- Payments
- Patent prosecution fees
- Reporting requirements
- Diligence obligations
- Sublicensing obligations

Payments

- Review records to ensure all payments have been properly made
 - License fee
 - Minimum annual payments
 - Milestones
 - Patent expenses, past and ongoing

Payment Due Dates

- Tracking royalty payment obligations
 - Invoices generated when payments are due
 - 30 days past due generates first overdue notice
 - Call licensee to determine why payment not made
 - When not paid within 60 days of due date, a final notice sent
 - Includes possibility of termination
 - When not paid within 90 days of due date, licensee is contacted
 - Sanctions discussed, including interest and/or termination

Definitions that Affect Payments

- Ensure you understand important definitions
 - Licensed products and/or licensed services
 - Net sales
 - Milestone triggers
 - Patent rights
 - Have any of the patent rights lapsed or expired?

Payment for Marketed Product

- If a product is being sold, confirm you've received royalty payments
 - Ensure you understand how net sales were derived from gross sales
 - If you haven't received royalties on any products, confirm those products don't fall under the license
 - Ensure royalty reports provide sufficient detail

Reality Check on Royalties

- Sales & earned royalty reporting
 - Compare to prior period sales figures
 - Look at licensee press releases, annual reports, governmental filings (SEC) and marketing reports, etc.
 - If inconsistent with sales report, licensee should be contacted to explain the difference
 - Audit is also a possibility, if agreement allows

Patent Expenses

- Patent expense reimbursement
 - Carefully tracked
 - Documented
 - Billed to licensee
- Has the licensee reimbursed the licensor for incurred patent expenses?

Reporting Requirements

- Review progress reports in a timely manner
- Have any of the milestone payment triggers been met?
- Has the licensee officially reported the date product sales were initiated?
- Address any inconsistencies with the licensee in real time

Development Progress Reports

- Verify that licensee is using the licensed technology or product
- Verify that an effort is being made to bring the licensed technology or product to market
- Provide verification that a license milestone was achieved and when
- Carefully reviewed and compared to the commercial development plan

Sublicensing

- Have any sublicenses been granted?
 - Does any sublicensee have product sales?
 - Do you have a copy of the sublicense?
 - Did licensee receive any sublicense income?

Setting up a Monitoring Program

Key Elements

- Licensee contacts
- Filing system
- Deadline tracking system
- Automated notices and reminders

Setting up a Monitoring Program

- Licensee contacts
 - Most important tool for tracking compliance
 - What information should be on the list?
 - Contacts in business development, legal, licensing, finance and research
 - Full names, titles, mailing addresses, phone numbers and email addresses
 - List should be periodically reviewed and updated

Setting up a Monitoring Program

- Filing System
 - Well organized filing system for filing and retrieving documents, reports, correspondence related to a specific license
 - Can be paper or electronic
 - Must be maintained

Setting up a Monitoring Program

- Tracking system for license terms and due dates
 - Computerized database is best
 - Integrated system that meets the needs of the entire office
 - Capable of tracking multiple license requirements

Setting up a Monitoring Program

Key requirements to track

- Due dates: payments, development milestones, reports
- Receipt dates of payments, reports
- Achievement date of milestones
- Financial detail on royalty & milestone payments, patent expense reimbursement

Setting up a Monitoring Program

Automated correspondence function

- Able to send reminder emails internally
- Routine form letters and reports
- Allows comments to be recorded
- Attachment of externally generated files

Royalty Audits

- Designed to “keep licensee honest” and ensure licensor that payments were correctly calculated
- Not necessarily instigated because of a problem
- Usually paid for by licensor unless audit reveals underpayment of more than a set percentage

Royalty Audits

- Choosing licensees for audit
 - Annual royalty paid \geq \$100,000
 - History of late payments
 - Payments that vary significantly by period
 - Rapidly decreasing payments
 - Sales reports that differ from publicly available information

Royalty Audits

- Examples of audit findings:
 - Misinterpretation by the licensee of what constitutes a licensed product
 - Some forms of products are exempt from royalty
 - Sales in certain countries are exempt
 - Certain types of sales are exempt
 - Products covered by pending claims are exempt

Royalty Audits

- Incorrect application of net sales definition
 - Incorrectly calculated on internal transfer price
 - Foreign sales are reported to US entity only in summary form

Royalty Audits

- Shenanigans
 - Does happen
 - Less likely than honest mistakes

Royalty Audits

- Costs
 - Depends on complexity of license
 - \$20,000 or more
- Recoveries
 - Depends on situation
 - Average = \$300,000
 - Recoveries have been in the \$10 – 50 million

Dealing with Noncompliance

Typical process

- Informal notice
- Sanctions
 - Interest on late payments
 - 'Not in good standing': negative impact on other transactions
- Formal notice with opportunity to cure
- Renegotiation: Payment plan, license amendment
- Termination

Strategy: Minimize Noncompliance

- Be proactive to minimize delinquent payments
- Keep in touch and keep tabs on licensee
- Standardize invoicing & collections
- Perfect the art of the demand letter
- Follow up and follow through

Be noisy!

Financial Compliance: Be Proactive!

- Proactive compliance program can ***dramatically*** reduce delinquent payments
 - Pre-due date reminders
 - Immediate, consistent past due notices
 - Periodic compliance reports to licensee
- By one account, noncompliance dropped from more than 60% to less than 5%

Promote Diligence Compliance

- Be proactive with progress reports: track due dates, provide feedback
- Maintain active relationship with licensees; e.g., semi-annual check ins
- Track licensees in the news: RSS feeds, local business news searches

Take Action

Train licensees to expect a response to noncompliance

- Standardize invoicing & collections processes
- Avoid pattern of accepting noncompliance

Demand Letters

- Demand letters should be short, direct, and demand specific action by specific date
 - Include **brief** history of the violation with references to license provisions
 - Ask for **specific** resolution
 - Always give **deadline**: *Contact our office within the next 10 days regarding your intentions to resolve this matter*
 - Get confirmation of delivery
- “Writing for the judge”

Termination

- Usually last resort
 - Rescue technology from nonperformer
 - Rescue technology from bankruptcy proceedings
- Formal breach & termination notice
 - Cure opportunity as provided by license
 - If licensee does not cure breach, follow up with notice of termination
- Objective: unambiguous termination leaving no cloud on technology
 - Inform others of termination e.g., patent attorney, inventors

Drafting to Enhance Compliance

- Standardize payment & reporting dates
 - Execution date v. calendar dates
 - Consider staff work flow too
- Provide disincentives for late and underpayments
 - Late payment fees & interest
 - Strong audit provisions
 - Self-audit requirements

Drafting to Enhance Compliance

- Draft unambiguous provisions
 - Clear and concrete triggers for payments & diligence
 - Preferably triggers can be turned into a date on the calendar
- Consolidate or cross reference reporting and payment requirements in single sections
- Include adequate detail in notice provision (e.g., specific title)
- Clearly describe consequences of termination

Questions?
Thank you!