

Licensing Management Services

“Strategies for optimising
royalty returns”

Cassandra Michie

August 2005

Optimising royalty returns



Three key stages to an effective licensing management strategy are:

Establish

Maintain

Protect

62% of Australian companies surveyed
do not have a formal program in place
to protect their IP*

* PricewaterhouseCoopers' Intellectual
Property Loss Survey Report 2001

Foundations of a licensing management strategy



- Capture relevant licensing data
- Integrate data into systems
- Monitor compliance
- Analyse reporting variance
- Follow-up anomalies
- Notify all licensees of compliance program

71% ⁽¹⁾ of licensors have never conducted a royalty examination, and licensees know which ones do and which ones don't



A royalty examination assesses compliance with the licence agreement, involving:

- Review licence agreement
- Analyse royalty statements
- Discuss purchase and sale of licensed product processes
- Examine licensee's books to account for licensed product
- Verify systems and procedures for reporting and payment of royalties
- Examine compliance with other licence agreement terms
- Prepare a report which quantifies misreported royalties
- Potential expert witness testimony

Our royalty examination process is designed not to impair the licensor/licensee relationship. Both parties can look forward with greater clarity and solid understanding of the agreement



Common issues arising from royalty examinations

- Contract interpretation
 - definition of royalty bearing sales – net sales, standard discounts
 - wholesale v retail
 - manufactured v sold units
 - unusual circumstances eg insurance
 - exchange rate calculations
 - end of period
 - average for the period
 - bundling

“Net is the same as gross, well at least we thought the auditors would never check”

Maintain



Other issues arising from royalty examinations

Over 90% of
our examinations
world-wide
uncover
underreported
royalties

- Clerical and accounting errors
 - Staff unfamiliar with agreements
 - Poor systems control/human error
- Transfer pricing/related-party transactions
- Omissions
 - Adjustments to sales
 - Scrapping or writing off stock
 - Exclusion of sales eg next generation or derivative products, internet, territories, related-parties
- Fraud
 - Two sets of books

Maintain



How to select a licensee for review

- Size
- Results inconsistent with expectations
- Poor or late reporting
- Discussion with relationship manager
- Future change in agreement such as new territory or product
- Random

Maintain



Benefits of a royalty examination

- ✓ Recovery of unpaid royalties
- ✓ Remedies any interpretation issues
- ✓ Encourages the licensee to improve future reporting
- ✓ Instils confidence in information received
- ✓ Improves predictability of future payments
- ✓ Sends message to other licensees
- ✓ Improves drafting of future licences
- ✓ Assess impact of changes in the IP

Leading companies are unlocking value and developing significant competitive advantage by employing third parties to determine if licensees are in compliance with royalty and licence terms

Business Wire, March 1999



Contract Review: terms to consider

- Definition of licensed product
- Royalty structure
- Index minimum payments
- Exchange rate calculations
- Penalties for delayed payments
- Rights to sub-license
- Derivative or next generation products
- Other provisions such as minimum spend on R&D or advertising
- Periodic reporting
- Maintenance of books and records
- Right to audit

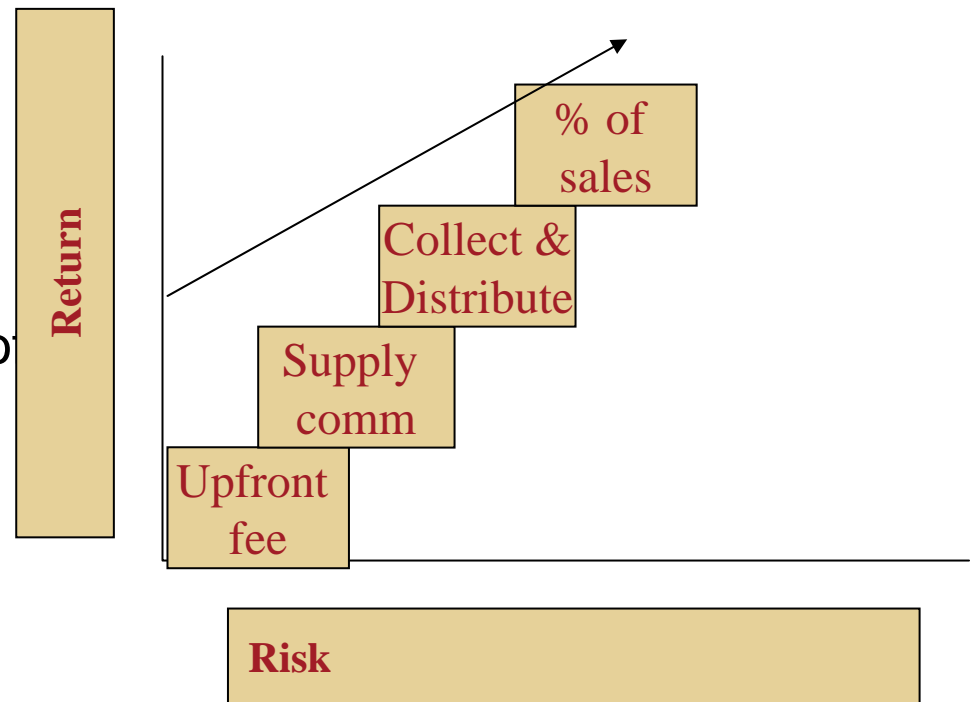
The Licensee must permit an accountant or auditor of the Licensor during ordinary business hours to inspect and verify all or any records required to be maintained by the Licensee under clause xx and any supporting records held by the Licensee. The Licensee must give all assistance necessary to that accountant or auditor to carry out the inspection and verification and permit that accountant or auditor to take copies of any of those records.

Establish



Royalties: how much

- Valuation
- Royalty benchmarks
- Assessment of incremental profit from use of IP:
 - cost savings
 - additional sales
- Discounts:
 - unproven markets
 - territorial restrictions
 - non-exclusivity
- Sub-licences





Royalty Structure

- Upfront payment
- % of revenue (tied to volume and price)
 - gross sales (does this include all revenue)
 - net sales (what deductions are allowed/disallowed)
- Price per unit (tied to volume only)
- Combination (external and internal sales)
- Minimum royalties (based on forecasts)
- Other supply/services/obligations

**There are many ways
to slice a cake –
be flexible**

Conclusion



A diligent proactive licensing management strategy will enable you to optimise your royalties and in turn optimise the value of your technology and protect your intellectual property rights.

Cassandra Michie is a PricewaterhouseCoopers partner and the leader of the firm's Licensing Management Services practice. With over 15 years experience in the public accounting profession, Cassandra specialises in forensic accounting.

Cassandra holds degrees in commerce, law and economics and has led numerous financial investigations in Australia, New Zealand, United States of America (involving a 3-year secondment to New York), Europe and Indonesia, involving matters ranging from financial misstatement to fraudulent activity including misappropriation.

Her experience in licensing management, includes reviewing commercial terms of licence and franchise agreements, researching potential licensing partners, undertaking royalty examination and franchise reviews to assess licensees/franchisees; and licensors'/franchisor's compliance with licensing terms, and assessment of any consequential damages.

Her industry experience encompasses a number of industries including retail, telecommunications, technology distributors, high technology suppliers, manufacturing, financial institutions, casinos, licensed hotels and real estate, and employment services.

Email: cassandra.michie@au.pwc.com