

Strategies for Negotiating Licenses

You will never get the license agreement your technology deserves. You get the license agreement you negotiate. With this in mind, it is important for inventors, licensing professionals and intellectual property lawyers to constantly hone their negotiating skills.

Below are some pertinent considerations.

Stay Away from the Negotiating Table A general principle in negotiations is that if you wait to commence negotiations until you reach the negotiating table, you will have already squandered leverage. Much of the framing of the negotiations can be accomplished away from the negotiating table. Inventors intent on approaching large companies to license their inventions should realize that they are negotiating anytime they try to influence potential licensees.

Inventors can increase their potential licensing value before approaching licensing partners by further developing their technologies; conducting competitive intelligence into the potential licensees in order to determine how the technology can best meet their targets' financial and strategic goals; and, by generating buzz for their technologies by gaining press attention by publishing (as licensing professionals monitor articles dealing with technologies they seek) or speaking at conferences.

A few specific examples of how value can be created away from the negotiating table emanate from Fred Smith, the founder of Federal Express. Many years ago, Smith wanted to acquire Flying Tigers, a struggling Asian carrier that had far more assets than upstart Federal Express. Before the negotiating began Fred Smith had his minions voice his steadfast resolve to keep his workforce union free. He derided unions as a plague on air carriers and proclaimed that he would never want to acquire a unionized carrier. Flying Tigers was unionized. Thus, the management of Flying Tigers was preemptively trying to determine what concessions they could grant Smith to compensate for the fact that they had a unionized workforce. More recently, Smith was in Eastern Europe discussing his aversion to the bureaucracy that exists in that part of the world. In doing so, he was planting the seeds for Eastern European governments to make concessions to Federal Express.

Just as many generals proclaim that battles are won or lost before they are fought, shrewd negotiators realize that they should avoid fair fights at the negotiating table. Rather, they should have the cards stacked in their favor before reaching the negotiating table. Consider the negotiations that ensued when Donald Trump identified the site to build Trump Tower. The owner of the property was Leonard Kandell. Kandell was also a savvy real estate mogul who preferred to retain ownership of the land and to lease it out on a long-term basis. Trump preferred to lease the land rather than own it outright. One would think that an agreement between Trump and Kandell could be reached relatively easily since there was an alignment of interests. However, Trump knew that going into negotiations with Kandell without leverage would not lead to the optimum results. Thus, before Trump began negotiating with Kandell he negotiated the purchase of air rights from Tiffany & Co. During these negotiations, Trump realized that Tiffany had an option to acquire Kandell's property at fair market value. Trump arranged to have this option included in the air rights deal. As a result, Trump had a stick in the form of an option to acquire Kandell's property if favorable leasing terms could not be negotiated.

How to Approach a Potential Licensee After the battlefield has been set, thought should be given as to how the licensee is approached. You have the least leverage if you approach the potential licensee directly. When inventors call licensing executives directly, their image in the eyes of the potential licensee deflates from being a successful inventor to that of a salesman.

There are advantages of an intermediary approaching the licensee on behalf of the inventor. First, the intermediary likely has a relationship with the right people at the various targeted licensees. Even if the

intermediary does not have a relationship at the licensee, they are more familiar with preparing the documents that the licensee will request to review. Finally, licensees will take some comfort that the intermediary has vetted the technology and would not want to damage his reputation by presenting an inferior technology.

Perhaps the way to obtain the most leverage with the licensee is to gain the support of an internal champion. Among the best internal champions are marketing professionals who stand to make healthy commissions on related products and subject matter experts from the research ranks. An internal champion will be much more effective in convincing his colleagues to strike a license agreement with your company than you will be if you simply contact a licensing professional at the target. Since most of the discussions to be held by the targeted licensee about the possibility of in-licensing will be conducted without the participation of the inventor, it is imperative that the inventor benefits from the consistent application of internal pressure.

William Cotreau of DuPont makes a further refinement to the issue of identifying an internal champion. If the technology is more pie-in-the-sky (e.g. earlier stage), technical people have more sway as compared to when the technology is ready to be reduced to practice. In the latter scenario the business people will hold more clout as the in-licensing of the technology will affect their operating budgets

Developing Walk Away Points A fundamental principle in negotiating is that you should never enter into negotiations unless you have the ability to walk away with reasonably good alternatives. Even during the negotiating process, one should continue to develop his walk away options. Thus, under such guidance, you should approach a non-ideal but accommodative licensee before you prospect the ideal licensee. The logic being that you can secure a walk away option when generating the interest of a secondary licensee which can be parlayed into leverage when negotiating with the ideal target licensee. Licensees often place a higher value on a technology when their competitors stand to be deprived of it.

While it is usually prudent to develop walk away points, there are some risks when applying this sequencing strategy in the world of licensing. Trying to bait an impulsive response on the part of a large organization with its intricate approval process is more likely to backfire than to yield results. If an assignee says that other large companies are interested, the solicited company can say that such interest is immaterial and that they have their own independent metrics and methodologies to determine which technologies and royalty rates are appropriate for them.

Large companies are inundated with solicitations to license technology. It is easier for them to reject a licensing opportunity than to pursue it. They have their own processes for vetting technology and their employees do not typically feel the same sense of urgency for executing a deal as do the inventors. In fact, when an investor bluffs by alluding to interest in their technology on the part of other potential licensees, they could derail the negotiations. This is because executives at big companies don't want to waste time working on deals that might get snatched away.

Preparation for Initial Negotiating Rounds A crucial step to take before negotiating is to coordinate your firm's objectives and goals of the negotiations. It is imperative that everyone from your team is reading from the same script otherwise you stand to be sabotaged by your own colleagues. It is often wise to make sure that you understand what your boss expects from the negotiations. For instance, I recently had a client who was highly confident that he could quickly close a relatively small license agreement. There was also a small chance of closing a major agreement further into the future. It accrued to his benefit to ask his boss which was more important to the organization: a high certainty of near-term revenues or waiting a few quarters to try to close a deal several magnitudes of orders larger.

In preparing for the initial negotiations, you should conduct competitive intelligence to ascertain the motivations, desires, pressures, and limitations that your adversaries have with regard to their licensing

programs. The following are among the answers that you should seek when conducting your due diligence:

- What are the company's licensing goals? How much pressure are the company's executives under to meet these goals? How important is your deal to the careers of the executives you are negotiating with?
- What is the importance of timing for concluding licensing deals? Can more favorable deals be completed before quarter or annual end?
- What are the company's accounting considerations? Do they prefer to expense or amortize IP related expenditures? (Royalties are paid out of cost of sales whereas upfront fees can be amortized over the life of the IP.)
- How are decisions made at the target licensee? By the relevant business division or a holding company that manages all of the firm's IP initiatives?

One method to accelerate the decision making on the part of a large company is to be very well organized in your dealings with such companies. I recommend to clients that they should ask their counterparts volleys of questions regarding how, when, and to whom information should be submitted. The better you understand the potential licensee's process, the more you can push forward your license agreement.

The more data and corroborating reports you can present to support your contentions the more convincing your arguments will become. Thus, you may want to have a strong opinion letter prepared before your meetings with licensees. Richard Woodbridge, Partner with Fox Rothschild in Princeton, NJ, suggests having your technology validated by a third-party organization such as the Wisconsin Innovation Service Center. You should have your financial modeling audited by an independent valuation firm such as IncreMental Advantage. Being well organized with all of the documentation at your disposal makes it easier for licensing professionals on the opposite side of the table to work with you. A side benefit of being well organized is that doing so lends credibility to your assertion that you are in conversations with other organizations. (If you claim that other large companies are considering licensing in your technology and your documents are not well organized, the other side will detect your bluff.)

The Opening Round Generally, the licensee will allow the inventor to begin the dialog. Allowing the inventor to discuss the technology educates the licensee. Further, allowing the inventor to discuss the merits of his technology and present his financial forecasts allows the licensee to poke holes in the inventor's arguments. From the licensee's perspective it is important to cut the inventor off if his projections are far beyond those of the licensee. Merely allowing the inventor to continue discussing his unrealistic expectations lends credibility to such expectations.

Licensees often articulate their walk away ability by mentioning that they have lots of talented engineers and scientists on staff who could design around the patented invention. Retorts to this credible negotiating gambit include:

- There are risks that the licensee may not be able to execute on their design-around initiatives.
- The costs for the licensee to design-around can ultimately exceed their estimates.
- Even if the licensee can develop an alternative to the technology under discussion, the licensee will experience delay in serving its intended markets.

- In fast moving industries, the licensee may miss a few product cycles if it delays its market entry.

When Your Lawyer Should Become Involved

There is some debate about how early in the negotiations lawyers should become involved. The general rule of thumb is that the more experienced the primary business players are, the longer they can wait to involve their lawyers. John Goldschmidt, Partner at Dilworth Paxson in Philadelphia, PA, believes that lawyers should be involved in the initial discussions. There are good reasons for this. First, lawyers represent a form of legal validation, can put the patent in play, as well as substantiate the principal's sincerity in seeing a deal through to fruition. Second, document drafting is often easier when an attorney has the benefit of participating in negotiations and understands the positions of both sides. A further refinement to this contention is that a translation problem often arises when the royalty calculations are discussed in the context of spreadsheets and decision trees and are then expected to be translated into contract language. It is thus prudent for the lawyer to at least observe the discussions that the finance and/or business people are conducting.

Third, an unsophisticated potential licensor can unknowingly place himself into jeopardy. For instance, let's assume an assignee has a patent with 10 independent claims and the patentee will endeavor to reach 10 different license agreements. If one of the potential licensees believes it is threatened by the assignee in one of the initial discussions, it can move to sue the patentee. If the potential licensee invalidates the patent, not only will the licensor forfeit a licensing agreement with the litigious potential licensee, but it will be prevented from pursuing license agreements with the remaining nine targeted licensees. What complicates this scenario further is that there is no definitive, static definition of what constitutes a threat.

NDA's & Memoranda of Understanding

The first legal documents that the licensor and licensee will consider presenting to one another are Non-Disclosure Agreements and Memoranda of Understanding. Licensors must divulge enough information about their technologies to interest licensees. Since licensors have a legitimate concern that their disclosures could be stolen by unethical licensees, it is understandable that they would request potential licensees to sign NDAs. However, licensees are often reluctant to sign NDAs because they may already be pursuing similar technology; they do not want to preclude another inventor from approaching them with a similar idea in the future; and, the idea might already be in the public domain. When large companies execute NDAs, such agreements are typically emasculated. In some cases having a licensee sign a NDA can be worse than no agreement as the non-disclosure can apply to the licensor but not to the licensee.

One benefit for a licensor in requesting a licensee to execute a Letter of Intent or Memoranda of Understanding is to determine the degree of sincerity that exists on the part of the licensee. There typically exists asymmetry in the sensitivity towards time in negotiating licenses. While the licensing professional from the large company usually receives a paycheck every week, the inventor may not. If the licensee refuses to sign a MOU without a legitimate reason, the licensor would have an indication that a deal cannot be struck with this potential licensee.

Despite this gating mechanism afforded by MOUs, there are several concerns with MOUs. First, as MOUs are contracts and therefore subject to state contract law, the enforceability of MOUs is not a certainty. Second, negotiators can handicap their own negotiating strategy by signing off on MOUs prematurely: they may be tied to terms that they object to and only come to this realization later in the negotiations when more information is elicited.

General Negotiating Techniques

The best negotiators do not view obtaining a signature on a license agreement as the ultimate goal of the negotiations. Rather, they view a long-term, lucrative relationship with the other side as the primary objective of the negotiations. Thus, the best negotiators adhere to the following best practices of negotiations:

- You must create value before you allocate value. Thus, you must learn as much as possible about the true motivations and needs of the other side. You should put as many issues on the table as possible so that you have more needs that you can satisfy during the deal structuring process.
- You should be hard on the problems that arise during negotiations but soft on the people involved. You may have to work with these people in one capacity or another in the future.
- You should set deadlines for resolving various pieces of the negotiations. Parties that cannot meet deadline requirements will not commit to reaching an agreement.
- You should realize that negotiating is analogous to dating. When selecting a mate you can not create a perfect partner by creating a collage of all of the best features from all of the people you have dated before. Rather, you must select from what exists. No one licensee will offer all of the most favorable terms that a collection of potential licensees promise to grant. Nonetheless, licensors have to select the best licensee from the pool of licensees that exist.

Negotiating Practices for Licensors Licensors often find themselves negotiating against potential licensees who are much more experienced in the art of negotiating and who hail from very large organizations. Here are a few bits of advice to inventors who must negotiate against giants:

- **Bring an Enforcer** Inventors should not participate in the initial negotiations alone. Bringing an experienced business person will help the inventor gain a deeper understanding of what the licensee's intentions are for the given technology. Another valuable role of the inventor's colleague is to act as an enforcer. It is more difficult for the licensee to renege on its promises when several people can recall them.
- **Responding to SOPs Gambits** Representatives from large companies often claim that they are only authorized to make narrowly proscribed proposals because of the standard operating procedures that exist at their companies. Licensors can refute these assertions by finding examples of licenses the company has entered into that do not conform to such rigidity. Another method is to illuminate how such standard operating procedures contradict relevant laws, regulations, policies, codes of conduct, organizational charters or constitutions, established practices, precedents, expert opinions, principles or logic.
- **Remove Valuable Players from Their Team** Inventors may be able to handicap a much larger company's negotiating team by removing one of their players. This can often be accomplished by pointing out potential conflicts or risks associated with such negotiator remaining on the team. For instance, if an executive was recently recruited from a company pursuing a technology similar to that being negotiated, the executive may be violating a non-compete or non-disclosure agreement.

Deal Structuring Options There are a near infinite number of ways that licensing agreements can be structured. The fact that an almost imponderable number of permutations are available in negotiating

licenses should be embraced because these options can be used to craft a deal more favorable to both sides. Below are a few tools that practitioners can use to structure mutually beneficial license agreements:

- **Step-Up Royalty Rates** Step-up royalty rates allow a licensee to pay low royalty rates early in the agreement and higher rates later in the agreement or subject to a triggering event (e.g. a specified level of production). The benefit to licensees is that they are relieved of paying higher royalty rates when they are incurring start-up costs and ramping up volume.
- **Step-Down Royalty Rates** Step-down royalty rates allow licensees to pay a declining royalty rate as they ramp up production of products incorporating the licensed technology. Step-down royalty rates incentivize the licensee to aggressively commercialize their licensed technologies.
- **Minimum Royalties** Requiring licensees to pay minimum royalties encourages the licensee to refrain from allowing the technology to languish. Also, if the minimum requirements are equitable, the licensee may believe it is not worth trying to design around the licensed technology.
- **Creditable Payments** One method to incentivize the licensee to rapidly commercialize the licensor's technology and to obtain a more attractive royalty rate is to state that initial fees and milestones are creditable against future royalties. License agreements can also stipulate that the fees that the licensee expends maintaining the licensor's patent prosecution program are creditable against future royalties.
- **Royalty Stacking** Competition requires that licensees consistently add enhanced features to their products. Thus, licensees often must license in more and more technology to remain competitive. If licensees were to maintain royalty payments for older technology at negotiated rates while licensing in new technology, they would bear losses. Thus, many licensees insist on royalty stacking provisions. These provisions hold that as the licensee executes new license agreements, it can reduce royalty rates on previous agreements by a specified percentage.
For instance, assume that two years ago licensee XYZ agreed to pay licensor A an 8% royalty. Let's also assume that the royalty stacking provision allowed licensee XYZ to reduce its royalty payments to licensor A by 50% of its future royalty obligations. Thus, if licensee XYZ agreed to pay licensor B a 4% royalty in the current year, licensee XYZ would be able to reduce its royalty rate to licensor A to 6% ($(8\% - (50\% \times 4))$). There are typically floors that address the extent to which royalty reductions can fall. Further, the royalty relief can be applied to other stipulations in the license agreement such as the milestone payments that the licensee is obligated to pay to the licensor.
- **Grant Backs** Grant backs occur when the licensor is granted access to the improvements that its licensees make to the licensed technologies. There are three main types of grant back provisions. First, "assignment" grant back provisions require the assignment of any improvement patent from the licensee to the licensor. Second, "exclusive" grant back provisions provide the licensor an exclusive right to use or sublicense any patented improvements, while the licensee retains only a non-exclusive right to practice the patented improvements. Third, "non-exclusive" grant backs allow the licensor to practice the improvement, while the licensee retains title and all other rights.
Grant backs are usually not granted when a major company is the licensee and the licensor is a small inventor. The reason is that the large company does not want to give the inventor a return on its investment. While grant backs are granted to other large companies that enjoy negotiating leverage, they are usually limited by specified fields of use restrictions. Interestingly, the use of grant backs is highly circumscribed in Europe because the European Union's anti-trust authorities believe that grant backs are uncompetitive.

- **Sublicensing** Rights allowing a licensee to sublicense a technology may enable the licensor to collect more royalties. In some situations a licensee possesses many more resources to license a technology than an inventor. In these cases, the licensor may not charge a license fee to the primary licensee. Rather the licensor expects to earn all of its royalties from derivative sublicensees. Sublicenses present a method for licensees to demonstrate their best efforts to monetize an inventor's technology and meet minimum royalty obligations.

A few concerns that inventors have with sublicensing include the licensee may not execute sublicense agreements with its competitors, thereby depriving the licensor of royalties. Also, it is important that the licensor have the rights to subject the second generation licensees to royalty audits.
- **Most Favored Nation License** Most favored nation terms hold that a licensee will only be required to remit royalties at the lowest rate that any other licensee is required to remit royalties. Similarly, most favored nation clauses ensure a licensee that if the licensor licenses the technology to another company, the imposed royalty rate will not be any less. One of the risks for a licensor who is contemplating granting most favored nation status to a licensee is that anti-trust complaints could be filed. A legitimate rebuttal to a request for MFN status is that the initial licensees obtained their licenses when there was more risk in so doing and they are therefore entitled to a lower royalty obligation.
- **Cross Licensing** Cross licensing takes place when two or more parties grant a license to each other for the exploitation of the subject-matter claimed in one or more of the patents each owns. Parties to a cross licensing agreement enjoy more freedom to design products covered by the others' patents without provoking a patent infringement suit. Another benefit of cross licensing is that companies can reduce their research expenditures since they have less need to work around competitors patents. Some companies file patent applications primarily to be able to cross license the resulting patents, as opposed to trying to stop a competitor from bringing a product to market. However, cross licensing erects barriers to entry. If the industry's major players have all cross licensed patent portfolios to each other, the new entrant would be forced to pay royalties to all its major competitors.
- **Intellectual Property Indemnity Insurance** Purchasing some intellectual property indemnity insurance provides a company negotiating leveraging. For example, when a business software company negotiates to sell its software to a large customer, the large customer will typically want to be indemnified if it were to be accused of infringement. Usually such indemnities are worthless. However, if the business software company can demonstrate that it has insurance that will stand behind the indemnity, it will have more negotiating power.
- **Fields of Use** Licensors can manage the fields of use provisions by allowing the licensee to enjoy broader to more restricted fields of use. For instance, the licensor may grant a broad field of use with the right to retract fields if it presents a use to its licensee and the licensee elects not to pursue it. On the contrary, a licensor may grant a narrow field of use and give its licensee the right of first refusal on other uses.
- **Combining Patent Licenses with Consulting Agreements** There are several benefits to combining patent licenses with tech transfer or consulting agreements. Noel Humphreys of Connell Foley in Roseland, NJ uses such arrangements to incentivize the assignee to become more active in commercializing the technology. While a patent underlying a licensing relationship stands the risk of

being ruled invalid, know-how carries no invalidity risk. Licensors can place confidentiality agreements on the transference of know-how. Having a consultant agreement accompany the license makes using the licensor's technology less expensive than designing around it. Combining a consulting agreement with a license agreement enables the licensee to extend the relationship until the conclusion of the consulting contract. (Other methods of extending a license agreement is to include inferior patents or patents approved in ancillary markets that terminate far longer in the future than the primary patents. These agreements usually expire on the expiration of the last patent.) A final benefit of attaching a consulting agreement with a license agreement is that this practice can ameliorate the impact of the MedImmune ruling which makes it easier for a licensee to sue a licensor in the process of trying to invalidate the patent.

John Goldschmidt from Dilworth Paxson makes another crucial point about patent-consulting combinations. When a consultant is consulting on a project, more intellectual property is often developed and it must be clear who has title to such IP. One way to handle this issue is to execute a Development Agreement which determines who is entitled to the newly created technology. These agreements often hold that title belongs to whoever contributed the most to the new technology or whichever company is most involved with pursuing the type of technology created. Another vehicle that John Goldschmidt uses is for both the licensor and licensee to jointly set up a new entity that will own the technology. A final concern for extending a deal too long based on know-how is that it may encounter anti-trust issues when the know-how becomes widely known.

Definitions in License Agreement The best negotiators think about compliance during the negotiations rather than leaving the issue of contract compliance as an afterthought for someone else to look after. One crucial component of compliance is to ensure that the agreement is clear. Even seemingly obvious terms should be defined; trigger events should be clearly demarcated; and, examples of the accounting treatments should be provided in the licensing agreements.

Negotiators should not delude themselves into thinking that the spirit of the contract will prevail: The principals that negotiated the licensing agreement will not likely be part of the compliance efforts in the ensuing years. As I tell attendees of my Negotiating Licenses for Maximum Returns course, everything becomes ambiguous when there is enough money at stake.

A term as seemingly self-evident as "sales" can become highly ambiguous. The following are areas of frequent dispute regarding what is deemed a sale for purposes of determining royalty obligations:

- On which sales are royalties to be paid? When sales are for full price, suggested retail price, discount prices (especially if the licensee may derive some other benefit in exchange for giving a discount)?
- Should royalties be paid on free samples? Sales to developing countries? Sales to non-profit organizations? Humanitarian sales?
- Are returned products still sales?
- Does it matter if the buyer is an affiliate versus arms-length end users? Which transfer pricing rules apply? Does a sale occur when a licensee gives the product to affiliates in return for a contribution to its research foundation?
- How do you account for bundled sales (i.e. the licensed item is sold together with other items for a single price)?

- How do you account for component sales (i.e., the licensed item is sold as a component of a larger item for a single price)?
- Should royalties be based on gross or net sales? Are royalties owed when the sale is invoiced or when cash is received? Which deductions are allowed (e.g. delivery costs or early-payment discounts)?
- Are royalties to be collected when the licensee receives an upfront payment from a distributor as a result of having won an exclusive distribution franchise?
- Are there different royalty schedules for selling in different countries?
- Are large customers entitled to receive price breaks upon meeting certain volumes? Do such price breaks reset every year?
- At what rate are currencies to be converted? Which dates are to be used for such purposes?
- Is the licensor entitled to royalties based on minimum guarantees that the licensee collects from sublicensees?
- Are royalties due when products are sold in countries in which the licensor has no patent coverage? Is the country of manufacture determinative in these scenarios?
- How are interest and penalties on late or underpaid royalties to be calculated? Is the interest rate to be simple or compound? What is the underpayment threshold which, when triggered, requires the licensee to pay for the royalty audit?
- Assuming that royalties are to be calculated on an annual basis, what is annual? Is it a calendar year or a defined rolling 12-month period?

Ensuring Compliance with License Agreement

A common practice to ensure compliance is to invoke royalty audits. Quite often, licensors recover millions of dollars in underpayments when ordering an audit of their licensees. Underpayments more often reflect the inability to account for all of the royalties due to the licensee, rather than calculated deception. Also, lots of large companies overpay their royalties because such royalties are not any one individual's money. What often happens is that a division controller who has been remitting payments to a licensee based on the production of a given product for many years will continue doing so even when such product no longer incorporates the licensor's technology. On the other hand, better managed companies require business division managers to sign off on royalty payments.

Caution must be taken when initiating a royalty audit. According to our research, as many as 20% of royalty audits result in findings that the licensee has overpaid the licensor and as a result the licensor must refund the licensee. Another concern with executing royalty audits is that local laws in foreign countries may hinder what can be discovered in terms of contested audits of royalty records. The following are a few ideas for managing the issue of royalty audits:

- Early in the negotiations phase, there should be some discussion of the accounting systems and practices that the licensee utilizes. The calculation of the royalties should conform—to some extent—

with the ability of the licensee to track their royalty obligations. There is no sense in negotiating an agreement and drafting a license that can't be enforced.

- It is highly recommended that royalty audits be conducted early—when disputes result from matters of interpretation—rather than several years into the license agreement when the dollar values are too high. Thus, one recommendation is to write into the agreement that there will be an audit after the first year of the execution of the agreement and that the cost of such audit will be borne equally between the licensee and licensor. This establishes a firm methodology for royalty accounting from the outset of the relationship. However, the implication that there may not be further royalty audits in quick succession may mean that the licensee will begin gaming the system after the first audit.
- Some licensors require their licensees to include a royalty audit as a component of their annual accounting audits. While the auditors hired by the licensee may not be as aggressive in finding indicia of underpaid royalties (since the royalty auditors retained by the licensors are compensated on the commission basis), this is a means to ensure some level of compliance. This method is further well-suited when licensors do not want to become too aggressive in their royalty audit demands because of other business interests between the two companies.

There are other means by which a licensor can gain visibility into how the licensee's business operates. For instance, when the licensor sells other components to a licensee, it can quickly determine how much product the licensee is selling, and by implication, the extent of the royalties they should be remitting.

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