

Strategies for Managing Underperforming Licensees: Enforcer, Counselor, or Both?

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It happens to every TTO once in a while. You licensed patented technology to a company that just isn't making enough progress, so your original expectations for licensing revenue, attainment of milestones, and associated fees aren't met.

What can you do? There's the nuclear option of clawing back the IP, but in many cases the better course might be to amend the agreement and begin looking for ways to support the licensee in reaching the specified goals.

The Cleveland Clinic Foundation recently found itself in a similar situation with technology licensed to Notox Bioscience, which is using patented IP relating to the treatment of a neuromuscular abnormality. The company is seeking to produce products in the areas of aesthetics, drug-free pain management, body contouring, and sweat control.

The company recently announced that Cleveland Clinic Foundation had agreed to amend the original terms of the licensing agreement, the third such amendment since 2013, and extend the deadline for Notox Bioscience to reach the first commercial milestone -- submission of regulatory filings -- to December 2023. The amendment also requires Notox Bioscience to begin making partial refunds of approximately \$215,000 of patent fees accrued by the Cleveland Clinic Foundation at the rate of \$25,000 per calendar quarter, the company announced.

The tech transfer office at Cleveland Clinic Foundation declined a request to comment on the amendment. Notox Bioscience reported that the license agreement is valid until the expiration of the last to expire of certain patents. "In accordance with the license agreement, we are required to pay the clinic a royalty based on the sale of certain products, a milestone payment upon the first commercial sale of the first such product, and a percentage of any sublicense," the company reported.

CEO Zoran Konevi said the amendment "signals that our key partnerships are stronger than ever, and it is also heartening to receive such fantastic support."

Tough love may be needed

That kind of flexibility and support is one way to go, but a tougher stance is warranted in some cases, says Alfonso Garcia Chan, JD, principal with the McKool Smith law firm in Dallas, TX. He focuses his practice specifically on litigating and licensing complex IP cases on behalf of universities, research institutes, and technology companies.

When your original expectations for licensing revenue and attainment of milestones and associated fees keep getting pushed back, your choice of action may depend on who is involved, Chan says.

"If the licensee is affiliated with the university and primarily staffed by professors and students, more patience may be needed to incubate and allow the company to grow to viability. Financial requirements should rarely be reduced, but timelines can be adjusted," he says. "If, however, the licensee is a more sophisticated commercial or industrial company, then the requirements and milestones should be more strictly policed with notices of breach, warnings, and audits."

But should you ever consider the extreme step of clawing back the IP? Chan says yes.

Again, consider who are you dealing with, he suggests. For a university-affiliated licensee, don't take the license back immediately when expectations are not met, but consider taking back the IP after one year of noticed noncompliance, he says.

“For a sophisticated licensee, the IP should be clawed back if an audit reveals fraudulent underpayments or underreporting of progress,” Chan says.

Short of severing ties altogether when the licensee’s progress is glacial, Chan says other specific actions can be employed to help the licensee keep trying while still protecting the patent owner. If progress is not on pace, consider narrowing or limiting the scope of the license, he suggests. Options might include reverting the license from exclusive to non-exclusive, terminating sublicensing rights, and/or accelerating the termination date, he says.

Know the circumstances

It also might be wise to consider gaining more understanding of what is behind the delays.

“A responsible TTO licensor should always understand -- but not necessarily agree with -- the licensee’s circumstances and reasons for non-compliance,” Chan says. “At the same time, a responsible TTO licensor should also keep its eye open for alternative licensees.”

TTO leaders also may wonder how much and what sort of investigation or audit of the licensee’s progress they should conduct. Chan says the licensor has every right to review critical financial records and other company information as outlined in the license agreement. Asking for proof of progress is not rude or an imposition, he says, and licensors should expect full compliance with such a request.

“Typically, a university-affiliated licensee requires only periodic interviews and disclosure of basic financial summaries, such as a balance sheet. But a sophisticated licensee should be able to corroborate all information in its progress reports with detailed financial records and work papers,” Chan says. “If a sophisticated licensee cannot produce such corroborating data for two or more consecutive reporting or royalty cycles, an audit should be strongly considered.”

Chan notes that TTO leaders may want to take a more relaxed and conciliatory approach when university researchers or students are involved with the licensee company. But only up to a point.

“The university TTO’s relationship with a faculty start-up should be more of a collaborative partnership, with defined but flexible boundaries.

However, this does not mean the TTO should be a pushover. Deadlines should not be repeatedly extended, nor should milestones be overlooked or forgiven,” Chan says. “This will help the start-up to incubate and grow responsibly, and further cultivate an ecosystem of innovation and accountability among other start-ups and licensees.”

The supportive approach

That collaborative, supportive approach is preferred by T. Gregory Tucker, PhD, commercialization manager in the Office of Research & Innovation at the University of Louisville in Kentucky. Though there may be scenarios in which more of a stern approach is called for, Tucker has found that steady involvement with start-ups and other licensees can help avoid most disappointing progress reports. Or at least they won’t be a surprise, he says.

Due diligence milestones seem to be the most challenging for some licensees to complete, Tucker says, and many have difficulty making milestone payments.

“I try to be very realistic in the beginning during the business term negotiations. Aside from the royalty rate, I try to look at their business plan and take a couple of milestones that are related not only to the technology but also to further commercializing it,” Tucker says. “For those milestones, I give them an extra six months or a year on the timeline.”

Tucker tries to have only three or four milestones altogether and to spread them out so that the licensee has a good chance of achieving them. But he says the milestones must be relevant and important enough that they are crucial to the successful commercialization of the technology. They should not be general goals that could apply to any start-up, he says.

"This could be something like a certification. Maybe it is not necessarily required but it helps to de-risk the business," Tucker says.

Pandemic impact

Tucker's TTO has been working with some start-ups to address milestone problems related to the pandemic, with some experiencing setbacks from shutdowns at physical locations and the supply chain issues that followed. Louisville has been giving them another six months to hit their milestones, which Tucker says has been helpful.

"Normally that starts with a phone conversation. It's important to be very personable with your licensees because for a lot of them this is their baby and it was their initial enthusiasm that started the process," he says. "What I've realized is that even though this is business, it's very personal. It's important to at least have phone conversations and not rely completely on e-mail communications."

Taking that idea further, Tucker says he is a fan of personally attending as many local events involving Louisville start-ups as he can. His attendance shows start-up founders that the university is supporting them beyond just providing the license, he says, and it helps him be a better commercialization manager when faced with difficult issues such as missed milestones.

When a licensee is struggling to meet milestones or otherwise failing to comply with the agreement, Tucker says his strategy is to act as more of a resource for them than as an enforcer. If the goal is for both the start-up and the university to benefit from the successful commercialization of IP, it is more effective to help remedy problems than to simply demand compliance, he says.

When a start-up is moving slowly, a likely cause is lack of funding, Tucker says. In that case, he tries to steer the start-up toward additional sources for potential funding, such as state and federal grants.

"It's also an opportunity to give a lot of education about the opportunities and details of the patent prosecution process," Tucker says. "That starts to build more trust too. We all get busy but it's important to give people more attention at some of those pain points as opposed to just saying they are not in compliance."

Steering faculty start-ups to an incubator or other opportunities to interact with entrepreneurs also can get the ball rolling, he says. That can help significantly when the progress failure is traced to the start-up being led or largely influenced by an academic researcher with little experience in the business world, he says.

Trust and accountability

Clawbacks have happened at Louisville in extreme cases of noncompliance, but so far Tucker has been able to avoid that final step. Even if other parties are interested in licensing the technology, Tucker says he would not consider that a sufficient reason to claw back a license that might still have a chance at success with the current licensee.

"It's a two-way street. There has to be trust and accountability -- trust that you're not going to just break an agreement because now someone else is interested in the technology and that the licensee is going to be accountable for those payment milestones and the non-payment due diligence milestones," he says.

From what information has been made public about the Notox Bioscience amendments, Tucker says it appears Cleveland Clinic Foundation has worked hard to be accommodating as the licensee faced obstacles to commercialization. Even if the effort eventually is unsuccessful, the TTO can be confident it did all it could and did not just abandon the licensee, he says.

"If you are communicative, then amendments like these can be made and it might work to every- one's advantage," Tucker says.

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