

Post-agreement monitoring of licensing deals

As IP rights owners are increasingly realising, some licensees are more trustworthy than others. A few key factors may prove crucial when enforcing a licensing agreement

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Licensing patents throughout the world involves dealing with various licensors from diverse cultural backgrounds. Southeast Asia is a hotspot on the licensing map: a manufacturing powerhouse for electrical components and electronic devices such as mobile phones, semiconductor chips, hard disk drives and direct-current (DC) brushless fans.

In mid-1990s Taiwan, the last of these products – and a substantive patent portfolio covering fans and their DC brushless drive motors – posed a particular monetisation challenge. The market for cooling applications for electronics was dominated by Japanese manufacturers, but appeared to be an area in which upcoming Taiwanese rivals could compete. Becoming aware of Taiwanese players in the market and identifying their need for in-licensing of DC brushless fan technology were the first steps towards a significant licensing programme.

As licensors are increasingly realising, some licensees are more trustworthy than others. This chapter looks at the case of a less reliable licensee and considers the steps that a prudent licensor can take to mitigate the associated risks.

Making a deal

DC brushless fans were purchased through vendors of a particular Taiwanese fan

manufacturer and patent attorneys verified the infringement of numerous patents in the portfolio in question. The Taiwanese company was approached and confronted with the patent infringement of its products. Negotiations were handled in Taipei and Taiwan with the help of a local attorney who was a native speaker of Mandarin, but was also fluent in English and held a US law degree.

The portfolio consisted of patents covering basic brushless DC fan technology in many countries; however, it was mainly the US patents that were cited in the negotiations, with the support of a US patent attorney. At that time, a US patent covered the largest single market for DC brushless fans used in electronics, especially for heat dissipation in computers, and the United States represented more than 50% of the global computer market.

As a result of arm's-length negotiations in Taiwan, the parties agreed to enter into a licensing agreement in Summer 2000. The agreement covered brushless DC fans sold by the Taiwanese manufacturer anywhere in the world. The agreement also covered the manufacturer's subsidiaries, including those in the United States and Japan. The non-exclusive and non-transferable licence, without right of sub-licence, granted the licensee the right to make, have made, use and sell licensed products under the licensed patents in any country, provided that it paid royalties in a timely manner.

Payments were to be made in US dollars on a quarterly basis. Each quarterly payment fell due at the same time as a corresponding written report, which was to be submitted within 30 days of the end of the calendar quarter. The reports were required to list the model numbers of licensed products, as well as net sales and the

number of units sold for each model. An audit clause stated that the licensee was required to keep records for the purpose of an audit, and stipulated that such information should be sufficiently detailed to enable the royalties payable under the agreement to be determined for a period of five years from the date to which they pertained. Audits of the licensee's books and records were to be carried out to the extent necessary to verify the records and payments for which the agreement provided, and were to be kept confidential. If the audit results showed an underpayment of royalties of more than 5%, the licensee would be responsible for the audit costs and a penalty (calculated as a percentage of the underpayment), as well as interest on the unpaid balance.

It was agreed that the agreement would be construed according to the laws of the United States and Illinois, with English the governing language. Both parties submitted to the jurisdiction and venue of the US District Court for the Northern District of Illinois, Eastern Division, for all controversies and issues of enforcement concerning the agreement. However, in the event of a breach by the licensee, the licensor could file suit in an appropriate court in Taiwan. The licensor reserved the right to cancel the licence if the licensee defaulted on or breached any material provision of the agreement, or failed to account for or pay any royalties or other payments due.

Maintenance visits

The licensor occasionally went to Taiwan to hold meetings with the licensee and gather information, particularly in order to verify the sales figures and prices reported in the quarterly royalty reports. Upon talking to representatives of the licensee, it became clear that the reported sales figures frequently did not match the numbers volunteered by the representatives. It proved helpful to keep returning to Taiwan, meeting representatives and obtaining data on production capacities, production volumes, product mix, customers and production facilities in China, among other things. Interviewing employees of the licensee on a yearly or twice-yearly basis in Taiwan allowed the licensor to verify the information given orally, which contradicted the reported sales numbers and suggested massive under-reporting.

The purpose of the visits to Taiwan was to hold meetings with the licensee and gather verifiable data informally, notwithstanding the audit provision in the licensing agreement. However, this approach will not work unless the licensee is cooperative. In this case, the licensee promised at almost every meeting to provide data to verify the royalty payments and the numbers reported, but the information in question was never received.

Attempts at auditing

In February 2006 an official audit was requested in accordance with the licensing agreement. A comprehensive performance assessment office – an independent Taiwanese organisation – assigned two auditors to the case, both of whom were fluent English speakers. Their report was disheartening. The auditors had been allowed to enter the licensee's facility in Taiwan, but the only information provided had been the royalty reports and the licensing agreement. Countless excuses had been given, and although the auditors had presented a list of the documents needed for review throughout the audit before visiting the licensee's headquarters, they had been sent back empty handed.

In a subsequent meeting with a representative of the licensee, the cat-and-mouse game continued, with the licensee trying to hide information and prevent the audit from proceeding while remaining in line with the licensing agreement. In a second attempted audit, the auditors were again not provided with the required information, which included sales account information, sales invoices, purchase orders, sales orders by serial number, bank account details and computer data. In blocking the auditors' attempts to gather information, and thus preventing them from investigating the suspected under-reporting that had come to light through the meetings conducted in Taiwan, the licensee was clearly in breach of the agreement. Despite its many patient attempts to resolve the issue amicably, the licensor had only one option left: to file suit in a court of law.

Litigation

The complaint was filed in the circuit court of Cook County, Illinois in accordance with the

licensing agreement, naming the licensee and its US subsidiary. It claimed a breach of a patent licensing agreement related to DC brushless fans. According to the complaint, the Taiwanese licensee had not properly reported or paid royalties to the licensor, which constituted a material breach of the agreement. The licensor claimed that the licensee had refused to allow independent auditors to perform an audit of its records in order to ensure that appropriate royalties had been paid. The licensor sought damages, including the royalties due under the licensing agreement, plus interest and legal costs.

The complaint was filed in late 2007 and served on the licensee, and litigation commenced. The Taiwanese defendant, which was represented by a Chicago law firm, tried to have the suit dismissed for lack of personal jurisdiction, despite the fact that the agreement clearly stated the venue. In January 2008, to the plaintiff's surprise, counsel for the defendant was withdrawn. In April 2008 the defendant was found in default for failing to appear, answer or otherwise plead.

In a June 2008 order, the circuit court held that the Taiwanese defendant had been properly served under the Hague Convention, as the US subsidiary had been properly served in the United States, and that by filing a motion to dismiss, the Taiwanese defendant had submitted itself to the court's jurisdiction. Although that motion had later been stricken and the licensee and its US subsidiary had been ordered to file an answer by March 2008, both defendants had failed to file a respective response or had otherwise disappeared, and were therefore found to be in default. A letter submitted to the court in May 2008 by the Taiwanese defendant failed to meet the standards for a legally sufficient answer or pleading. The plaintiff filed a motion indicating that it had notified both defendants of the prove-up date both in the United States and in Taiwan, but that the defendants had failed to answer or otherwise appear. The defendant was ordered liable for a seven-figure sum and did not appeal the judgment.

The question arises as to how the plaintiff was able to substantiate damages satisfactorily before the court. Certain sales amounts had been provided to the licensor orally during

meetings with the licensee in Taiwan. It was thus possible to establish, through an affidavit of the witnesses who had been present at the meetings, that the sales figures had been provided to the licensor. This was sufficient proof to serve as a basis for the award of damages.

A private investigator was hired to find information about assets of the licensee or its US subsidiary in the United States. It transpired that the licensee had not only closed the US subsidiary, but also shifted its import channel from the US West Coast to a port in Canada. The verdict had to be enforced in Taiwan, since all assets in the United States seemed to have disappeared. With the help of the local Taiwanese attorney, who had been a reliable partner for 15 years, it was possible to do so, and enforcement of the US court order in Taiwan against the Taiwanese defendant's assets was successfully pursued.

Conclusion

In the end, two factors were crucial in this case: persistence in gathering information through maintenance meetings in Taiwan and the ability to prove the relevant content of the licensing agreement in sufficient detail before a US court. As a result, it was possible to track down the licensee and prove its under-reporting. With the help of the experienced US patent attorney, the local Taiwanese attorney with fluent English and the local auditors in Taiwan, proof of underpayment was established and an enforceable verdict and a substantial financial return were obtained.

Anyone involved in licensing in Southeast Asia, especially Taiwan, would be well advised to consider such steps when enforcing a licensing agreement. **iam**

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Mr Papst began working for an IP law firm in Munich, becoming a licensed German patent attorney in 2005 and joining Papst Licensing in the same year. In 2009 he became one of the company's managing directors. He is a member of the International Association for the Protection of Intellectual Property, the Licensing Executives Society, the International IP Strategists Association and the Institute of Electrical and Electronics Engineers, among others.

Papst Licensing was established in 1992 by Georg Papst, Daniel's late father, and is owned by Daniel and his two brothers. Papst Licensing allows small and medium-sized businesses to participate in the world patent monetisation and licensing market.