Larry and Barry, As Royalty Investors, Consider Appropriate Penalties For Scaled Royalties Revenue Shortfalls

Arthur Lipper

Intrepid royalties investors Larry & Barry are discussing the "Scaled Royalties" technique. This method, for which a dynamic model has been developed at REXScaledRoyalties.com, allows companies to receive benefits if they consistently exceed projected revenues, and provides for investors to receive adjustments in their returns if companies consistently miss projected revenues.

Larry: What should be the penalty if they disappoint and don't have sufficient revenue in the Selected Adjustment Period (SAP) to meet the test?

Barry: The website REXScaledRoyalties.com calculates the amount of shortfall in both revenues and applicable royalties. Therefore we know the amount of the difference between what we were paid and what would have been paid if they had met their revenue projections.

Larry: Yes, and we could require they simply paid us in cash the amount which would have been paid, had the revenue projections been achieved.

Barry: Of course, we can effectively change the terms of the deal to that which would have been the case in REX-RIAR.com and require that the revenue projected be simply minimums. The problem is that this is unlikely to be acceptable to the royalty issuing company, as they believe they will have much greater revenues than projected; but their inability to meet the minimum in the SAP indicates they have some real problems.

Larry: Yes, and we want to be both fair and constructive as forcing them to take an action which is unsustainable isn't In our interest. We don't want to own or run their business.

Barry: We could let them pay us the differential in a note and just continue onwards with the same royalty. The note could be interest-bearing and accrue interest for an agreed period.

Larry: We could also extend the royalty payment period for the period necessary for us to be paid an agreed amount, possibly X times the amount of the shortfall.

Barry: We could also increase the royalty rate in future years, perhaps until a multiple of the differential is paid to us.

Larry: We want to be known as being fair and neither disabling to the royalty issuer or earning increased profits, as so many lenders do. Their penalty charges are sometimes the basis for their profit.

Barry: Of course, it all depends on the situation, as we may simply want to look to using the critical assets of the company being held for our protection.

Larry: We may have to become more involved, though we want to be sure that we are never in a position of assuming the burden of ownership.

Barry: What else could we do?

Larry: We could require that they raise additional capital, even if it meant their present owners no longer controlled the company.

Barry: And we could require personal guarantees from both the owners and others of the amount of differential, and perhaps a multiple thereof and also the amount still unrecovered from the cost of the royalty.

Larry: Right. We want to be as helpful and flexible as we can be, assuming we believe the situation still has the potential to become successful. It's important that we discuss and agree with the company in advance about what technique will be used for redress, should it become needed in the future. No surprises, no doubts.

Barry: Since we have the mechanism for knowing the current revenue payments and can see problems significantly earlier than the end of the SAP, we should have a dialogue with the owners of the royalty issuing company as soon as we become concerned with the disappointing revenues.

Larry: Yes. It is always better for all concerned to face problems once recognized. Perhaps we should have an earlier trigger point in the SAP in the case of disappointing revenues.

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