

Beyond Negotiations: Agreement Monitoring

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Introduction

The execution of a license agreement is the beginning of a long-term relationship to the mutual benefit of both parties. The success of this relationship depends upon the understanding of the parties as evidenced by the written agreement. The monitoring of the agreement is the process of understanding and enforcing the terms of the written agreement such that the goals envisioned by the parties are attained. Goals for public institutions usually include public benefits, such as the availability of novel goods and services, and income to the university and its scientists.

Unfortunately, the process of agreement monitoring is often given a low priority when offices are understaffed or place a higher priority on using limited resources for deal making resulting in insufficient resources for agreement monitoring. This is a difficult position. Diligent agreement monitoring is good business practice and should be emphasized or, at least, not ignored. A well-conceived and implemented monitoring program is vital to assuring that the technology is being developed and that royalties and fees are paid. While the monitoring of all types of agreements should be routine, this chapter offers guidance on the monitoring of patent license agreements.

Reading the Agreement

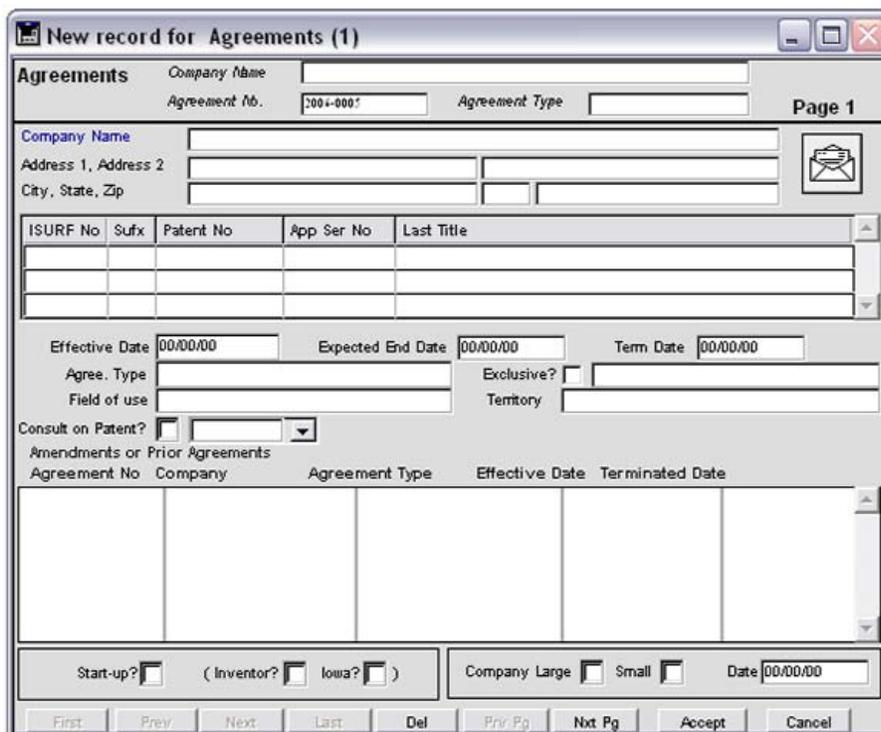
A license is an agreement in which the owner allows use of its intellectual property in exchange for consideration, generally in the form of royalties and fees. Effective monitoring of the license begins by a thorough reading of the agreement to understand what the licensor is giving and what it is receiving in return. A good system to follow is to begin by reviewing the grants and consideration clauses. The grant section describes what is being provided to the licensee in the form of intellectual property rights. The consideration section describes what compensation the licensee is providing in exchange for its right to

use the intellectual property. Particular attention should be paid to other sections of the agreement including definitions, payment and report due dates, termination provisions, as well as all obligations of the technology licensing office (TLO) to the licensee.

Tracking License Compliance

Electronic agreements-management databases are critical to effective agreement monitoring as they allow staff to track events and obligations. Some offices use commercially available databases, while others chose to develop proprietary systems. An agreement-tracking form may be used to summarize the agreement for the purpose of tracking the obligations of the licensee and provides means for the licensor to follow up on the critical dates. An example of a tracking form is shown in figure 1. Critical elements of an agreement-tracking system employing an agreement-management database are discussed below.

Figure 1: New Agreement Input Forms



New record for Agreements (1)

Agreements Company Name: _____ Agreement No.: [000+0000] Agreement Type: _____ Page 1

Company Name: _____
 Address 1, Address 2: _____
 City, State, Zip: _____

ISURF No	Sufx	Patent No	App Ser No	Last Title

Effective Date: [00/00/00] Expected End Date: [00/00/00] Term Date: [00/00/00]
 Agree. Type: _____ Exclusive?
 Field of use: _____ Territory: _____
 Consult on Patent? _____

Amendments or Prior Agreements	Agreement No	Company	Agreement Type	Effective Date	Terminated Date

Start-up? (Inventor? Iowa?) Company Large Small Date [00/00/00]

First Prev Next Last Del Prv Pg Nxt Pg Accept Cancel

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New record for Agreements (1)

Agreements Company Name: Agreement No.: 2004-0001 Agreement Type: Page 2

Agreement Language

Section	Section Title	Description	Amended?	Amend Date

General/Main Contact Name, Phone: Assign Main
 Reimbursement Contact Name, Phone: Assign Reimburse
 Prosecution Contact Name, Phone: Assign Prosecution

Follow-up Dates

Date	What's Due	Ref	Description	Done?

First Prev Next Last Del Prv Pg Nxt Pg Accept Cancel

New record for Agreements (1)

Agreements Company Name: Agreement No.: 2004-0001 Agreement Type: Page 3

First Sale

Sale Date	ISURF Numbe	Product Name

Agreements Maintenance Correspondence

Author

Date	Correspondence

First Prev Next Last Del Prv Pg Nxt Pg Accept Cancel

Contact Information

In the database, record the various individuals with responsibility for particular aspects of the license. Within any given company, different individuals are often responsible for royalty reporting, development reports, and patent prosecution. Generally, the license lists one agreement contact person. A phone call to the contact may be necessary to determine the individuals to be contacted regarding royalty reporting, patent-cost reimbursement, and development reports. The database should include the names and addresses, as well as phone, e-mail, and facsimile numbers, for all relevant contacts.

Type of Agreement

Indicate the type of agreement, i.e., license, option, testing, research, etc., and the type of license grant, i.e., exclusive, nonexclusive, field exclusive, etc.

Relevant Dates

List expected end date and effective date.

Agreement Status

Indicate if the agreement is active, expired, or terminated.

Licensed Intellectual Property

Include a list of the intellectual property covered under the agreement including the licensed patent and patent application numbers.

Reporting Obligations

Briefly describe the reporting and payment obligations for each of the due dates. This part of the database should be designed so that all obligations can be queried and accessed by due date. A regular monthly scan of the due dates for all active agreements should identify the reports and payments due. Past-due reports should be automatically flagged also. A robust system will prompt managers to check for particular milestones or other relevant information during a designated period. Since every licensee relationship is different, inclusion of a comments field in the database can be useful.

Correspondence

Post or link relevant correspondence to the agreement.

Amendments

Develop a system to track all amendments to the license. Most agreements are amended from time to time, and tracking these changes is essential to properly monitor the agreement.

Obtaining Reports and Payments

Obtaining reports is simplified if the license agreement is unambiguous and can be clearly interpreted. Well-constructed agreement terms accurately define the information to be provided and specify the exact due dates by employing date-certain language. To determine when reports and payments are due or past due, the license portfolio should be reviewed on at least a monthly basis. Upon execution of each new license agreement, it may be helpful to the licensee for the TLO to inform the licensee of the due dates for development, royalty, or other reports that will be due. At this time, it is also good practice to provide the contact information of the TLO agreement's administrator, if different from the person who negotiated the license. Issues relating to obtaining reports are discussed below.

Reminder Notices

It is sometimes helpful to provide reminder letters to licensees, prior to the due dates. Reminders are particularly helpful for newly executed agreements. Sending reminder notices may prompt the licensee to review the license and assign reporting duties to the appropriate parties.

Late Reports

Following up with licensees on late reports and payments can be time-intensive. In most cases, the reports will be provided after discussing the matter with the licensee.

Understanding the issues related to the late reports and being flexible in resolving problems related to reporting is often necessary to preserve the relationship. If the licensee is not responsive, sending a notice of default may be appropriate. Since failure to cure a default can lead to termination of the license, it is important to send the notice to the party identified in the notices section of the agreement and to follow the protocol outlined under

that section. You may also want to have the letter reviewed by counsel, particularly if you suspect that termination of the license is likely.

Late Payments

As with late reports, collecting on past-due amounts often requires flexibility, especially with smaller companies. For small companies, cash flow can make it difficult to pay large invoices for patent-cost reimbursement or even to pay royalties and fees. Discussions with the company are necessary to resolve the payment issues, and rescheduling payments may be appropriate. Most license agreements provide for late-payment penalties; assessing such penalties often results in more timely payments.

Reviewing Royalty Reports

Records and payments provided by the licensee must be reviewed to make sure all payments including fees, minimum royalties, and earned royalties are paid and that the information provided in the reports is accurate. If earned royalties are being paid, a report detailing the calculation of royalties should be provided. In reviewing the reports, be particularly attentive to problems. Table 1 lists certain red flags that could alert you to a problem. Earned royalty reports should be completed by containing all of the information required under the agreement. A sample royalty reporting form is shown in figure 2. Several issues related to reviewing reports are discussed below.

Table 1: Royalty Monitoring Red Flags

- Reports are inaccurate, incomplete, or lack detail
- Reporting periods are skipped
- Late reports and/or late payments
- Royalty contact person is unresponsive
- Payments during the same reporting period decline from year to year
- Any change in the way royalties are reported or calculated
- Earned royalties never exceed the minimum
- Change in ownership of the company
- Change in reporting contact person
- Change in address or phone numbers without notice
- Licensed products are advertised but not included on royalty reports
- Sublicensing income not reported
- Checks that do not clear the bank

Figure 2: Sample Royalty Reporting Form

Licensee name:
Reporting period:
Date of report:

Royalty Reporting Form

Product (list products by name)	No. units sold	Invoiced price per unit	Gross sales	Allowable deductions (attach item- ized detail)	Net sales
Product name					
Product name					
Product name					
Product name					
Total					

Total net sales	\$
Royalty rate	
Royalty due	\$

Total royalty due: \$ _____

Report prepared by:
Title:
Date:

Please send royalty reports and payments to:
Licensor name:
Address:

Insufficient Royalty Calculation Information

When royalties are based on sales, the TLO should require itemized reporting of the sales amounts and applicable deductions and require that the licensee show the details of the royalty calculation. When royalties are calculated based on other parameters, such as units or usage, these parameters should be reported. A well-documented royalty report showing how the royalties are calculated helps determine if royalties are being calculated as provided under the agreement. Well-documented royalty reports provide important information for an auditor, if an audit of the licensee is performed at a later date. To assist the licensee in reporting all the relevant information, it may be necessary to provide an example of a report to the licensee, as the party responsible for completing the report may not have been aware of what was required under the license.

Mathematical Errors

All computations should be reviewed for accuracy. Any discrepancies should be discussed with the licensee, and any appropriate adjustments should be made and result in accurate reporting and payments. Cases of overpayment should also be discussed under the circumstances, a credit to the next royalty payment may be necessary.

Calculation Errors

Review the report for correct calculation of fees and royalties including the basis for royalty determinations, which is often net sale. Deductions should be itemized as per the definition used in the license. Watch for any vague or unauthorized deductions.

Questionable deductions should be discussed with the licensee.

Indecipherable Reports

Royalty reports that are unclear are not informative. A discussion with the licensee may help clarify the information required under the license. In some cases, the royalty reporting form may not have been appropriately designed. Revisions to the form could help clarify reporting.

Figure 3: Sample Development Plan

Licensee name:

Report date:

Technology title:

Development Plan

Development plan of the scope outlined below shall be submitted to TLO by licensee upon execution of this agreement. In general, the plan should provide TLO with a descriptive summary of the activities that licensee believes are necessary to make products available for sale in the commercial marketplace. Estimated start and finish dates or time lines should be included where appropriate.

- I. Development program (describe steps to be undertaken and the time required)
 - A. Describe development activities
 - B. Provide development time line
 - C. List governmental submissions require
- II. Describe market approach
- III. Competitive information
 - A. Potential competitors
 - B. Potential competitive devices/compositions
 - C. Known competitor's plans, developments, technical achievements
 - D. Anticipated date of product launch

Total length: approximately 2-3 pages

Please send development plan to:

Licensors name:

Address:

Figure 4: Sample Development Report

Licensee name:

Report date:

Technology title:

Development Report

- A. Date development plan initiated and time period covered by this report
- B. Development report (4-8 paragraphs)
 1. Activities completed since last report including the object and parameters of the development, when initiated, when completed and the results
 2. Activities currently under investigation, i.e., ongoing activities including object and parameters of such activities, when initiated, and projected date of completion
- C. Future development activities (4-8 paragraphs)
 1. Activities to be undertaken before next report including, but not limited to, the type and object of any studies conducted and their projected starting and completion dates
 2. Estimated total development time remaining before a product will be commercialized
- D. Changes to initial development plan (2-4 paragraphs)
 1. Reasons for change
 2. Variables that may cause additional changes
- E. Items to be provided if applicable:
 1. Information relating to product that has become publicly available, e.g., published articles, competing products, patents, etc.
 2. Development work being performed by third parties other than licensee to include name of third party, reasons for use of third party, planned future uses of third parties including reasons why and type of work
 3. Update of competitive information trends in industry, government compliance (if applicable), and market plan

Please send development report to:

Licensor name:

Address:

Reviewing Development Reports

At about the time a license is signed, the TLO should require the licensee to submit a product-development plan outlining the steps it will take to bring a licensed product to market (see figure 3). It is important to note that many business plans designed for investors may not have adequate information describing the particular steps to be undertaken by the licensee in the development of products. Development plans should specifically describe the product-development activities to be undertaken and a time line for completing these activities. Any government approvals should be noted as well as time lines for completing other necessary activities that may have an effect on the commercialization of products under the license. After the license is executed, the licensee should provide development reports showing the progress made by the licensee in meeting the goals set forth in the development plan (see figure 4). Both development plans and reports should be reviewed by an individual within the TLO who is familiar with the licensee's business plan and/or with the inventor as appropriate. Unreasonable delays or frequent changes in the focus of the development plan may indicate that the licensee is experiencing difficulties that could lead to business failure. This may be particularly true for small firms. Lack of progress may also indicate the licensee is no longer emphasizing development of products under the license. In either case, discussion with the licensee is necessary to determine if the licensee is likely to be able to perform under the license. If not, then consideration should be given to termination of the license.

Constructing Effective License Agreements

It is an unfortunate reality at some institutions that the licensing officer who negotiated the agreement may not remain at the TLO long enough to discover if the results are as envisioned by the licensing officer. As a result, the officer responsible for monitoring the license may not be the individual who negotiated and arranged for the execution of the agreement. A licensing officer responsible for reviewing an agreement without benefit of the author's input may require assistance in interpreting certain terms. One of the best training tools available for a licensing officer is to participate in the agreement-monitoring process. Many of the difficult issues that surface in license monitoring relate directly to the license language. Drafting license agreements is beyond the scope of this chapter, but it is worthwhile highlighting areas that are critical to effective monitoring.

Defining Terms

Define terms clearly and carefully, so that they can be accurately interpreted by someone not familiar with the intent of the parties. Unless defined otherwise, the standard understanding of the word will be used by the courts in interpreting the intent of the parties. Definitions of particular importance are listed below.

Licensed Product

Licensed product is often disputed during audits. Since the definition of licensed product is the basis for the royalty calculation, the term should be carefully constructed. Avoid using vague terms. Be specific in defining the licensed product and relate that definition to the patent being licensed, for example, consider incorporating the following term into the agreement, “*Licensed Products* are products that employ or are in any way produced by the practice of an invention claimed in the Licensed Patents or that would otherwise constitute infringement of any claims of the Licensed Patents.”

First Sale

Agreements often use *first sale* to a customer as a trigger date. Without auditing a licensee, it can be difficult to determine when the first customer was invoiced. Under certain circumstances, relying on the licensee to report that date may be unrealistic. A suggested alternative is to define first sale as the end of the quarter in which sales reach a certain dollar amount, e.g., \$100,000.

Royalty Calculations

Specifically identify the method by which royalties are calculated. Keep the method as simple as possible. Royalties should be readily documented and easily determined. The invoiced price of the licensed product is the standard basis for royalty calculations. Avoid basing royalties on a percentage of gross profit or cost or on any other method that is subject to change based on the licensee’s cost-accounting allocations. Base royalty calculations on invoiced amounts rather than amounts collected.

Royalty Deductions

What deductions are appropriate—returns, shipping costs, installation fees? What about promotional products that are not invoiced? What about combination products? If the licensee requests that deductions be made, it is important to understand the basis for the request. Only agree to deductions that are reasonable and make good business sense.

Reporting Periods

Quarterly reporting based on a January 1 to December 31 calendar year is recommended. More frequent reporting generally is not practical and places a burden on the licensor and licensee. Annual reporting may leave too much time between reporting periods, and irregularities may not be recognized in a timely fashion.

Make Obligations Date Certain

Date-certain obligations are readily monitored, for example, a report “due on or no later than December 31, 2010,” is easier to follow up on than a report “due 30 days after completion of a study.” When it is likely that an agreed-upon deadline will not be met, it is reasonable to expect the licensee to contact the TLO and explain the delay. If the reason for the delay is acceptable to the TLO, the agreement may be amended to reflect the new deadline.

Describe What You Expect to Receive in Your Reports

With the exception of very small companies, the individuals completing the reports usually will not be the same as those negotiating the agreement. Advise the licensee what is expected in the report to the licensor. Consider including examples of royalty and development reporting forms as exhibits to the license.

Special Issues for Startup Companies

Startup companies often present a management challenge for the TLO. Entrepreneurs managing startups wear many hats and can be difficult to contact. In some cases, responsibility for the license is delegated to a staff member unfamiliar with the agreement. In such cases, well-structured reporting forms can help the TLO clarify and communicate

effectively with the startup. A willingness on the part of the licensor to renegotiate terms or modify provisions based on the changing business environment may be necessary. Any arrangement to change the terms of an agreement should be carefully documented. While formal amendments are often executed by the parties, less formal agreements for rescheduling payment or reports can be effectively managed by a letter from the TLO indicating its acceptance of the change.

In some situations, conflicting objectives of various parties within the university can make it difficult for a TLO to manage its licenses effectively. While such conflicts are not limited to startup companies, the potential for conflict is greater for startups with close ties to the university. For example, a TLO may be in a position where it extends deadlines or waives payments with little justification. This can place the TLO in a difficult financial position or prevent it from seeking other licensing opportunities. Ultimately, the commercial opportunity may be lost.

Third-Party Audits

Auditing is a management tool that is discussed in detail in another section of this manual, however, it is instructive to highlight the below listed considerations in this section.

- While auditing is important, it should be considered after other remedies have been sought and should not be a substitute for effective agreement management.
- Auditing every licensee is generally not practical due to the costs and resources required.
- License agreements generally specify a document-retention period of usually five years. As a result, audits conducted after the retention period may not allow for the inspection of all documents.
- Good agreement monitoring and regular communication with the licensee can help guide the licensee in developing an internal accounting system resulting in accurate reporting.

Bankruptcy

While many license agreements include a clause terminating the license if the licensee files for bankruptcy, most legal experts agree that this provision affords little protection to the licensor. Once a licensee files for bankruptcy, an automatic stay is imposed, which

prohibits any termination of the license. In addition, the trustee has the power to void transactions with the licensor entered into ninety days before the filing of the bankruptcy petition. The potential adverse effects of a bankruptcy filing on the licensor make it important for the TLO to monitor the financial status of its licensees and to act quickly to restructure the agreement when problems arise. To preserve some rights for the licensor, the TLO may be successful in negotiating changes to the agreement. Such changes could include reducing the license grant from exclusive to nonexclusive or restricting the field or territory. In any event, by addressing problems before a bankruptcy petition is filed, the TLO may be successful in reducing the uncertainties associated with bankruptcy.

Visiting Licensees

By visiting the licensee, the TLO shows its interest in the company. The visit may also allow the TLO to gain valuable insights into the licensee's business as well as the industry as a whole. Visiting a licensee is a valuable opportunity to further establish the business relationship. While face-to-face meetings at the licensee's place of business can be an effective approach to solving problems, a visit without a particular agenda can also be instructive. In meetings, company officers often share information about their businesses that they have not considered sharing with the TLO or were too busy to communicate. Such information can include updates on research projects and strategic alliances, new distribution or marketing channels, and other information. Licensees are usually very interested in showcasing their operations.

Conclusion

The time and effort required to monitor agreement compliance is a significant investment of TLO resources. Regular contact with the licensee can provide timely information to the TLO and makes it easier for the licensee to communicate issues affecting the license, such as cash-flow problems, potential infringement, new sublicenses, or other matters. By establishing and managing an agreement-monitoring program, the TLO helps to ensure that licensees fulfill their obligations and that the technology commercialization and financial goals of the institution are met.

Notes

George H. Keller, Steven M. Ferguson, and Percy Pan, "Monitoring of Biomedical License Agreements: A Practical Guide" NIH, *Pharm Dev Regul* (1) 3: (2003) 191-203.