

Carnegie Mellon University



**UTEN Technology Transfer Workshop
Coimbra, Portugal
November 8 - 10, 2009**

Information and Communication Technologies Institute
CarnegieMellon | PORTUGAL

AN INTERNATIONAL PARTNERSHIP

FCT Fundação para a Ciência e a Tecnologia
MINISTÉRIO DA CIÊNCIA, TECNOLOGIA E ENSINO SUPERIOR

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DAY TWO

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License Provisions

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BIG PICTURE OBSERVATIONS:



A few big picture observations (when reviewing/ negotiating a license (or any contract) with a potential licensee):

- Before drafting, understand the material points (big picture) of the arrangement from a business perspective
 - e.g., for a research use license: what is the research; where will it be performed; who will perform it (third parties?); how long; who will own results of research (or improvements); how will the IP be transferred; whether the IP is confidential; what is the IP to be transferred; can a research use license even be granted, etc.
 - Huge time waster negotiating/editing provisions if the “big picture” is not clear or agreed

BIG PICTURE OBSERVATIONS:



- Understand the reason for each provision and why it is worded the way it is
 - Difficult to appropriately react to comment, deletion, etc. from a potential license if you don't know the reason for the provision
 - Understand what effects the comment, deletion, etc. has on other provisions

BIG PICTURE OBSERVATIONS:



- Understand whether the change is a business or legal decision and who makes the decision. If it's a business decision, who is impacted (and who should weigh in?)

BIG PICTURE OBSERVATIONS:



- If you don't know what it means, feel free to ask (and don't agree to it)
- It's not a bad thing to admit that you don't know something/don't understand (It's difficult to make a mistake by doing so)

BIG PICTURE OBSERVATIONS:



- Instead of saying “we just can’t (or don’t) do that” or “we aren’t allowed to do that” to a potential licensee, understand why you just can’t do that and explain it, and try to find a good alternate (better yet, good alternates)

BIG PICTURE OBSERVATIONS:



- Try to understand why the comment, deletion, etc. is being made and/or what the potential licensee really wants (it will help you find a good alternate and/or agree to the provision, etc.)

BIG PICTURE OBSERVATIONS:



- Everyone makes mistakes; two people should read/ think about the licensee's proposed changes, etc.
- Lengthy (or large) negotiation conference calls or in person meetings are often not necessary (after the initial discussions)
- Understand how business deal changes various provisions (and all provisions that are affected, e.g., sublicensing, international license, notice provisions, tax language)

BIG PICTURE OBSERVATIONS:



- Mary Beth's main concerns: Is CMU protected (e.g., indemnity and insurance and no warranty and freedom to operate) and how does CMU get paid?

License Provisions that are Important to CMU



- Education/Research/Government Purpose:
 - In every exclusive license, CMU retains the right to use the licensed technology for academic, education, research and administrative purposes. CMU also tries to retain the right for other non-profits, etc. to use the licensed technology
 - Compare license Section 2.4 with 2.5
 - As an aside, if the federal government funded the invention, the government retains a non-exclusive license. As well, if there has been previous licenses granted, e.g., research use licenses, they need to be excepted out (i.e., the license grant is subject to those rights)
 - CMU requires licensees (exclusive and non-exclusive) to grant CMU the right to use licensee's [sublicensee's] derivatives for academic education, research and administrative purposes (mainly so that CMU's efforts aren't blocked)

License Provisions that are Important to CMU



- Minimizing Legal Exposure – No Warranties/ Limitations on Types of Damages; Indemnification; Insurance
 - Warranties (actually, no warranties):
 - ✦ SEE LICENSE. CMU does not make warranties. Why not?
 - ✦ CMU is a major educational and research institution. CMU does not have expertise in patent law or patent or IP searches. The licensee must do its own due diligence concerning any patents, etc. The licensee must determine for itself that practice of the patent and that the licensed technology has commercial potential.
 - ✦ Licensed technology is the product of research efforts (not commercial efforts)

License Provisions that are Important to CMU



- Warranties (actually, no warranties) continued:
 - ✦ Royalty pricing does not include this expertise
 - ✦ The licensee is the expert concerning development use and creation of a commercial product from the technology licensed. It knows that business and CMU does not
 - ✦ “CMU” is comprised of 4,000 independent employees. What one employee knows, another may not know
 - ✦ Etc.
 - ✦ Limited exceptions apply (e.g., “to the knowledge of the employees of CMU’s Center for Technology Transfer and Enterprise Creation”)
 - ✦ As an aside, deleting a word from the “no warranty” paragraph does not mean that the concept behind the word is now warranted

License Provisions that are Important to CMU



- Limitation as to Types of Damages:
 - ✦ SEE LICENSE. Damages limited to direct damages only (which can exceed amounts received)
 - ✦ It's nonsensical to make this paragraph mutual (e.g., neither party will be liable to the other party or any third party). If mutuality is okay, except out interest (an indirect damage, breaches of confidentiality and licensee's indemnification obligations)
 - ✦ On occasion, CMU will further limit its damages to amounts PAID (e.g., licenses on the web, discrete licenses)

License Provisions that are Important to CMU



- Indemnification:

- ✦ Indemnify means protecting the indemnified party from lawsuits or claims brought by third parties who suffer damages as a result of the subject matter of the indemnity (versus suing for breach of contract)

Defend means legal defense

Hold harmless means to absolve the indemnified party from any responsibility for damage or other liability arising from the subject matter (broader than indemnify)

- ✦ SEE LICENSE. The indemnity provision is very broad. Licensee's liability under CMU's standard indemnification provision is similar to strict liability (liability without regard to fault). The provision is like insurance (insures against CMU's own fault, negligence, gross negligence, etc.)

License Provisions that are Important to CMU



- Indemnification continued:
 - ✦ In various jurisdictions, the law is that indemnity against one's gross negligence cannot be enforced and may even be against public policy. CMU's due diligence processes, etc. are designed to ensure that it is not grossly negligent (or negligent!)
 - ✦ Can be modified somewhat. "Sublicensees" must indemnify as well
 - ✦ Indemnity is extremely important to CMU. CMU has absolutely no control of what commercial product will be generated from the licensed technology nor how it will be used or administered. The exposure is great relative to the small amount of royalties that are or will be received. CMU's licenses aren't terminable at CMU's option, etc.

License Provisions that are Important to CMU



- Insurance:
 - ✦ SEE LICENSE. Licensee needs insurance to back up its indemnity obligations (CMU must be named as an additional insured) or have significant assets (along with a financial reporting obligation)
 - ✦ Particularly for a start-up, the cost of maintaining insurance may be a real and genuine burden. Until there is a product which is produced and then delivered to third parties, there may be limited exposure to third party liability. Therefore, it can be acceptable to permit a delay in obtaining insurance covering CMU until: e.g., a product is created which involves individuals or other recipients outside of the licensee, or until the first product sale or the first sublicense of the technology

License Provisions that are Important to CMU



- **Sublicensing (and getting paid for sublicenses):**
 - Non-exclusive licenses
 - ✦ Non-exclusive licenses are typically not granted the right to sublicense without the consent of CMU (because the potential sublicensee can simply obtain a direct license from CMU)
 - There are, however, situations where it may be appropriate for a non-exclusive licensee to obtain sublicensing rights (e.g., the licensee's business model is that it will be adding value to the licensed technology and sublicensing a bundle of rights, including the licensed technology, to sublicensees)

License Provisions that are Important to CMU



- Exclusive licenses
 - ✦ Much-debated point for years within CMU's tech transfer/OGC as to when to allow sublicensing and under what parameters (distributors, first tier, etc.). Issue in determining when it was appropriate for CMU to give consent and what was required (e.g., review of sublicenses, check of potential sublicensees, etc.)
 - ✦ SEE LICENSE. After much debate, CMU decided on the approach that exclusive licensees can receive the right to sublicense if the licensee (i) passes through CMU's standard language in its sublicenses, (ii) agrees to pay the same royalties (not a royalty on a royalty), (iii) agrees that it will cause its sublicensees to indemnify, etc., (iv) agrees to the other standard sublicense provisions, and (v) sublicensee responsibilities are stated throughout the license
 - ✦ This way, CMU doesn't have to read sublicenses, approve sublicenses/sublicensees, etc. (of course, could indirectly pick up a "bad" sublicense this way)

License Provisions that are Important to CMU



- Sublicensing with consent
 - ✦ Could be completely impractical
 - Impractical to review sublicenses
 - What should CMU be consenting to?
 - Who should be able to give consent?
 - What does the license say about royalties for sublicensees?

License Provisions that are Important to CMU



○ Sharing of sublicense income

- ✦ Most sublicense provisions call for sharing, or passing-through, of income “realized” by the licensee on account of the sublicense.

Variations include:

- Royalties – Generally, the sharing takes the form of a pass-through royalty or a percentage (e.g., 40%) of whatever amounts the licensee realizes from the sublicensee. Combos also work (e.g., lesser of pass-through royalty or $\frac{1}{2}$ of amount realized, but no lower than ___%)
- Other – Receive a percentage of upfront and on-going license fees, milestone payments, and other amounts realized from the sublicense (payments for research and development, screening or other services are almost always excluded)

License Provisions that are Important to CMU



○ Survival of sublicenses

- ✦ A sublicense is contingent on/feeds from the license (thus, generally, the sublicense automatically terminates upon termination of the license, unless the license states otherwise). Licensees often want (rightly so) its sublicenses to survive termination (due to commercial impracticability otherwise)
- ✦ In its licenses, CMU:
 - Has agreed to let sublicenses survive for a period of time necessary to negotiate a new license directly with CMU (on substantially the same terms) provided royalties are paid directly to CMU, etc.
 - Has agreed to negotiate in good faith with sublicensees for _____ period of time
 - Has never agreed to let a sublicense survive automatically in perpetuity beyond the above (and won't assume any sublicense). This is particularly true since CMU currently does not review sublicenses in advance (under current sublicense strategy)

License Provisions that are Important to CMU



- Spin-Off License:
 - SEE SPIN OFF LICENSE
 - It's essentially the same as the regular license, with spin-off provisions added
 - Problems with spin-offs:
 - ✦ Equity:
 - Paperwork, paperwork, paperwork: shareholders agreements, operating agreements, voting, etc.
 - Subsequent agreements always (attempt to or actually) override license terms
 - ✦ In general:
 - Provisions are always edited, etc. CMU okay to a certain extent. Big picture: a whole lot of negotiation by the licensee, for a little bit of hardly anything

License Provisions that are Important to CMU



- License Templates:
 - Probably will be substantially edited within a year or so



Deal Valuation and Structure

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Deal Valuation and Structure



Value is a price agreed upon by a willing buyer and a willing seller.



Valuation Methods

- **Book Value**
 - Value carried on balance sheet
 - Of a company = total assets - intangible assets and liabilities
 - Initial outlay of an investment
- **Net Present Value of Future Series of Cash Flows**
 - NPV of Future Revenues
 - NPV of “exit” event
- **Comparables**
 - Relative value compared to other similar assets



Valuation Methods for Technology Transfer

- **Book Value**
 - Do not usually carry the value of patents/ know-how/ copyrights on balance sheet of university
 - Initial “investment” or outlay may be useful to know, possibly help estimate “replacement costs”, not usually directly correlated to value
 - Should consider of future costs (esp. patent expenses)/ future investments
- **Net Present Value**
 - Useful in estimating value of future royalty stream
 - Licensee may have information in the form of revenue projections - reasonable to ask for, especially with spin-offs as part of business plan
 - Market Research in space/ like product or market revenues



Valuation Methods for Technology Transfer

- **Comparables**
 - Many public databases/ SEC filings if public company
 - Historical precedent/ consistency at university
 - Examples from colleagues
- **Replacement Cost**
 - “Going rate” comparable for particular industry/ field
 - Especially useful for non-exclusive/ commodity model (software)
 - Equal or acceptable alternatives
 - Re-creation cost (copyrighted software) - what would it cost (in time and \$\$) to rewrite the code?



Factors Effecting Valuation of the Deal

- Size of market
- Opportunity to open new market or cannibalize existing one?
- Component/improvement of product or new product
- How much additional investment will be needed to bring the technology to the market?
- The characteristics of the particular market
 - How large are the margins?
 - Specialized or commodity?



Factors Effecting Valuation of the Deal

- Platform technology? Single field of use?
- Scope of grant
 - Exclusive/ non-exclusive
 - Territory
 - Field(s) of use
- Strength of alternatives/ competitive factors
- Open Source
- Protectability/ Enforceability of IP



Factors Effecting Valuation

- Ease of work around/ Re-creation
 - Value is in time savings
- Value of tacit knowledge
- Freedom to operate
 - Needed by Licensee?
 - Needed from others to practice technology?



Factors Effecting Deal Structure

- Business Model of Licensee
- Time to Market
- Overall Probability of Success
- Scope of License Grant
- Value of the Technology
- Preferences of Licensee
 - Royalty % of sales vs. annual fee
- Preferences of university
 - Is fully paid up ok? For the right price? Is equity acceptable?



Financial Structure of a License

- Royalties
 - % of Net Sales
 - Periodic Payment
 - 1 time (“paid up”)
 - Sometimes calculating Royalty on Net Sales is difficult
 - Primary mode of revenue generation in license
- Upfront payment
 - Exclusive
 - High Risk
 - Long development time
 - Encourage diligent pursuit (“investment”)
 - Highly competitive



Financial Structure of a License

- Annual Minimum Payments
 - Encourage diligent pursuit
 - Expectation of return during development period
 - Trade guaranteed payment for lower royalty rate
 - Structure - Declining? Accelerating? Product life cycle? Static?
 - For life of agreement? Development period? Royalty period?
- Milestone Payments
 - Payments for risk lowering events
 - Shared risk university and licensee
 - Often tied to “value” events for licensee (i.e. regulatory approval, 1st sale, fundraising, etc.)



Financial Structure of a License

- Equity
 - Trade for up front payment specifically
 - Trade for overall lower deal terms
 - Shared risk
 - High risk/ high reward
- Sublicensing Royalties
 - Royalty flow through
 - Royalty on a royalty
- Termination Fee
- Patent Reimbursement *****

Deal Valuation and Structure



Unfair generalizations based on one person's experience:

Software Licenses 1 (High replacement costs/ High Value of Tacit Knowledge)

- Royalties
- Moderate up front payment (for exclusive)
- Annual minimums (for exclusive)

Software Licenses 2 (Low replacement costs/ Low Value of Tacit Knowledge)

- Low Royalty; or
- Series of Payments

Deal Valuation and Structure



Generalizations (con't)

Pharmaceutical/ Biotech/ Medical Device Licenses

- High Upfront payments (sometimes Equity)
- High Milestone payments
- Royalties
- Patent Reimbursement
- Sublicense Fees

Medical Device Component/ Biologics

- Moderate Upfront payment (exclusive)
- Annual Fee
- Sublicense Fees



Other Provisions Effecting the Value of a Deal

- Royalty anti-stacking provisions - fine, but understand the royalty rate just went down
- Royalty on a royalty sublicensing - Licensee has complete control based on their deal with sublicensee
- Sublicense fees and other payments that are not based on net sales - Need another way to capture; otherwise incentive to avoid payment structure based on net sales
- Shareholder rights - Make sure you have them and prepare for “cram downs”