Really Crummy Deals

2005 AUTM Annual Meeting

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What Makes Them “Crummy Deals”

- Somehow, something went wrong, and you wound up attracting the needle on the ol’ blame-O-meter!
- You feel you should have been smarter, should have quibbled the deal to death, should have developed ESP, and most of all, you should have recognized the licensee for the bucket of rats it turned out to be
Some Types of “Crummy Deals”

• The Black Hole – the licensee turns a modest inartfulness in your drafting into a black hole, which they claim has sucked all of your money away

• The Pretzel – the licensee twists your contract language into a distorted shape reminiscent of a pretzel, or the bulging veins in your temple

• The Synonym Finder – the licensee describes income from your invention using words not used in the license, and claims this justifies not sharing the money with you

• The Rear View Mirror – the inventor, a dean, etc., who used to be happy with the deal, demands that you to get the technology back, or at least get a much higher royalty
How Do Crummy Deals Happen?

- We all learn by experience; why is it that the deals we cut our teeth on are the ones that survive?
- At the time we close the deal, we are bearers of great opportunity; when it comes time to pay royalties, we are the tax collector.
- We can’t anticipate everything that might happen in the 20+ year life of a company and its products (If we could, we’d be rich by now).
- At some point, lawyers become cheaper than royalties.
- Modest royalty income makes some people ask, “why not more?”
Why Talk About Them?

• They aren’t funny when they happen to us, so we have to laugh about them now!
• To help us think about how license terms may be applied (or mis-applied) long after the deal is done
• To help us learn to write license agreements that are more “bullet-proof”
• To help us realize that we all have bruised shins, but they make us tougher, and our deals stronger
• Thinking of them as “really crummy deals” helps us laugh at our plight!
Nobody on This Panel Ever Deserved Blame for a Crummy Deal

• But they have HEARD about some crummy deals, and have handled some caused (of course) by somebody else!

• As we review them, please jump in and offer examples.

• We will assume you were an innocent bystander, or were cleaning up someone else’s mess.

• Feel free to change the story to protect your innocent (or not so innocent) self!
Crummy “Oops!” Deals

John Ritter
Princeton University
The Invisible Licensee

- The Net Sales definition does not include revenues from sublicensees, joint venturers, etc. and that’s who ends up selling licensed products.
The Invisible Income

• Your contract allows you to receive a royalty on sales of Licensed Products by anyone but doesn’t speak to other forms of payments like, upfront fees, milestone payments, etc.
The Unemployment Line

- You forget to include a reservation of the right to utilize the technology for the university and/or faculty member
  - Should also include right to grant research licenses to other non-profits, especially if the invention is a research tool!
The No Way Know How

• You exclusively license “know-how” that is necessary to practice some or all future inventions of the faculty member.

• Usually best to be non-exclusive
  – Must be well-defined
  – Written
  – Covering only prior know-how
  – Sent to Licensee by a date certain after the agreement
  – Could also put a clause in that allows publication to render the information non-know how
The Mark of “Zero”

• You do not have an adequate definition of Net Sales, leaving out a category of product, process, or service, that the licensee may use to generate revenue
The Ricky Ricardo (aka “You’ve got some ‘splainin’ to do”)

• Your definition of net sales basically gives you a right to receive a percent of the revenues received by your licensee. The licensee subsequently sublicenses the technology to a third party and receives a royalty based on their sales, leaving you with a percent of a percent.

• Example: 5% royalty in both licenses and $100,000,000 sales would leave you with $250,000 in “royalties” OUCH!
The “InArtful Dodger”

• Your patent attorney drafts numerous claims, all of which are allowed but none of which cover the eventual product, process, or service to be sold in the marketplace.
Crummy “Surprise!” Deals

Pamela L. Cox
Marshall, Gerstein & Borun LLP
The Reverse Houdini

• University made all the patent costs disappear:
  – Reimbursement of all past patent costs
  – Payment for all future costs of filing, prosecuting, maintaining, enforcing and defending the patent rights

• But unexpectedly, the patent costs reappeared:
  – Inventorship dispute
  – Ownership dispute
No You Didn’t

• Licensee says its complying with the diligence requirements but University knows otherwise:
  – Implied obligation (license is silent)
  – Commercially reasonable efforts
  – Development plan
  – Timeline
  – Reverse incentive payments
The Uninvited Guest

• Licensee prevailed in removing the government rights clauses (there was no federal funding at the time of the license)

• University retained rights for research and first actually reduced the invention to practice using government funds

• Government now has rights
Clutches of Time

- Licensee’s position: pay only if an issued claim covered the product
- Compromised position: pay if claims are pending for <5 years
- Early milestone payments were made but later ones were not because claims didn’t issue within 5 years
The Ghost

• The grant of rights includes “have made” but there is no mention of:
  – Who can make product for licensee
  – What notice the University gets
  – What records are required to be kept
  – Where the manufacturing can occur
  – Whether the audit provision applies
If You Didn’t List It, You Shouldn’t Allow It

• Royalty or sublicensing revenue deductions:
  – As a percentage of profits
  – Less research and development costs
  – Less value added taxes
  – Not including equity in licensee
The Devil You Know

- License conveys rights to licensee
- Licensee = licensee and affiliates
- Unknown affiliates practicing rights and granting sublicenses
Razor/Razorblade

- Patent rights cover a multiple component product or system
- Licensee discounts or gives away the product or system covered by the claims
- Licensee’s revenue comes from sale of related staple articles of commerce
Crummy “Honeymoon” Deals

Jeff Skinner
University College London
Honeymoon Deals

- Agreements where we are receiving consideration *now* for something we are giving *later*, typically:
  - More IP (not yet conceived)
  - More work (R&D, consultancy)

- Most commonly found where:
  - The is a high ‘know how’ component to the IP
  - Spin-outs where faculty are part of the deal.

- Quite separate from ‘conflict’ issue.
Why Are We Tempted?

• To respond to legitimate commercial issues raised during negotiation, for example:
  – To ensure faculty commitment
  – Need for a solid IP base/pipeline
  – Undermining of licensed IP by next invention
  – To cement a ‘good ongoing relationship’

• Keeps everyone happy (short run)

• Avoids confrontation – buys goodwill

• Does a deal where underlying IP is weak

• Achieves a ‘better’ deal (e.g., more equity)
Marry in Haste...

• In the short run (honeymoon period)
  – Faculty happy (you didn’t get in the way)
  – President happy (seems a good deal)
  – Licensee/spin-out happy (ties you up)

• In the long run (six months to 5 years)
  – Faculty blame you when they fall out with licensee
  – President blames you when lawsuits threatened
  – Company blames you for reneging on deal
The Siphon

• Licensee argues that:
  – current IP is interesting but real value lies in future
  – Can’t risk losing the ‘pinch of salt’ invention.

• Often uses ‘next investor’ tactic.

• Feed on mutual desire to retain faculty commitment.

“Do you really mean you’d license the next invention to a competitor?!”
Seems Reasonable, So…

• You accede limited rights to future IP.
• Malignant variations:
  – the ‘First Option’
  – royalty-bearing
• Deal gets signed – flood of endorphins & relief.
And Then…

- Faculty inventor:
  - falls out with CEO/CSO:
  - resents ‘having’ to license next big idea.
- Other inventors want a cut or object to deal
- Research sponsor objects or wants a cut
- Company gets avaricious – e.g. when first program fails
- Tragedy:
  - Probably would have licensed to them anyway!
  - IP gets locked up for years in stalemate.
  - Goodwill withers (replaced by ill-will)
  - You pray for no future IP/ company to fail/ faculty to leave!
What Do You Do?

• Circumscribe rights to IP by:
  – Field (but a whole new can of worms)
  – IP dominated by claims of first patent
  – IP exclusively by original inventors.
  – IP that you are free to license.
  – Rights to negotiate or information (rarely acceptable).

• However:
  – Any such discussions are a slippery slope.
  – Bound to end in sleepless nights
  – Better to explain folly of approach.
What Would Solomon Do?

- Scenario analysis (c.f. Hindenburg): help licensee & faculty to see:
  - where pipelines lead (collisions)
  - why issue is a legitimate show-stopper for you
  - that goodwill and more IP flows from good relationships and fences
- Be prepared to accept deal based on today’s IP.
- Ensure faculty is negotiating as separate party (with own advice).
- Emphasise ‘good fences make good neighbours’ (especially given inevitable change in players).
- And, of course, ‘We have a policy’!
The Chocker

• Licensee argues that:
  – they need continued Faculty involvement
  – as result of the deal, other companies will get interested – can’t risk poaching.

• You also want Faculty member to focus.

• Agree to ‘R&D agreement’ with added bite:
  – Non-compete
  – Penalties for cancellation (part of good/bad leaver provisions).
  – Restrictions on publication
  – IP rights (but fuzzy project definition).
Then…

- Faculty falls out with CEO/CSO over direction/priorities.
- Company terminates – tries to reclaim unvested ‘equity’.
- Other companies wish to collaborate.
- Frightens off:
  - Govt/charity sponsors (transparency?)
  - Other faculty…
Solomon Again

• Don’t need exclusivity on know-how – they have patents

• R&D, perhaps, but no Trojan Horse agreements

• If only know-how, then try consultancy

• Insistence on restricting Faculty will:
  – cause resentment
  – kill other funding sources (golden goose)
  – kill collaborations (window on world)

• Relationship sustained by mutual need, respect
  – not threat of litigation!
The Scrooge

- Company needs further R&D
- Has limited cash
  - Reduce burn rate to reduce dilution
  - Simply cannot afford
- Pleads ‘relief’ on indirect (sometimes direct) costs, citing shared equity & good-will
- Tempted - TLO benefits equally from subsidy
- Problems:
  - What’s given for owt is valued at nought
  - Trojan horse (what else can they use?)
  - Ill-will results when arrangement ends
Roll Over Solomon

• Don’t reject if deal makes commercial sense
• All shareholders benefit, so all should pay (VC’s wouldn’t provide cash at cut price)
• Separate entirely from IP deal – you are making new investment
• Structure as loan:
  – Interest-bearing (to compensate for risk?)
  – Convertible?
• Prevent future whinging by building in limits at outset:
  – Duration
  – Size
Common Threads

• All reasonable requests – in our nature:
  – to consider, debate the issues
  – not to reject out of hand

• All slippery slopes:
  – Can’t foresee future – so difficult to plan or value ahead
  – You can’t agree to stay friends – you need to work at it
  – Folk are contrary:
    • If they have to they don’t want to
    • If they don’t have to, they often want to

• Some deals enforced by mutual need:
  – Holding to account results in stalemate, game playing, ill-will
  – Future-proofing leads to far greater complexity – KISS!
To Avoid Sleepless Nights...

- Recognise that past and future contributions are two different currencies.
- Build respect, not friendships!
- Deal with what exists now and - the future is a separate transaction.
- Don’t commit to things you can’t deliver.
- Take value when it’s created – not before.
- Remember who has to live with the deal (you).
- Take the high ground – the marriage, not the nuptuals.
- You show me a good loser and I’ll show you a loser:
  - Stick to your guns
  - Don’t be too reasonable!
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