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**INTRODUCTION**

- Goal today
  - Introduce building blocks as a foundation for more advanced concepts

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## PRELIMINARIES

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### WHY DO AN EQUITY LICENSE IN THE FIRST PLACE?

- Not because everyone else is doing them;
- Not for the optics or inventor ambition;
- Because startup does not have the cash to pay up a fair license initiation fee;
- Because diversify financial returns for University; and
- Because pure all cash license does not fit (exceptional case).

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### EQUITY LICENSES ARE INHERENTLY MESSY

- Cash licenses to established companies are difficult.
- Equity licenses to startups are much harder, slower and expensive.
  - Significant additional complexity
  - Not all the players may be at table
  - Not enough money to reduce all the risks or solve all the problems
  - Path to exit is highly uncertain and far off

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### POSSIBLE UNIVERSITY ROLES

- Employer
- Licensor
- Investor/shareholder
- Founder
- Fiduciary – manager and/or director
- Strategic research partner
- Economic development catalyst

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### ALTERNATIVE DEAL STRUCTURES TO EQUITY LICENSES

- Additional milestones;
- Assignment fee; or
- Additional other financial considerations.

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### DON'T ACCEPT EQUITY UNLESS YOU UNDERSTAND THE MOST LIKELY PATH TO LIQUIDITY

- Start from the vision for the exit and work back to the deal terms that matter.
- Exit alternatives for Company or University:
  - Failure of the Company or the product;
  - Comprehensive sublicense;
  - Sale of product line or license;
  - Insider buys out University equity position;
  - Sale of Company; or
  - University sells equity following public offering.

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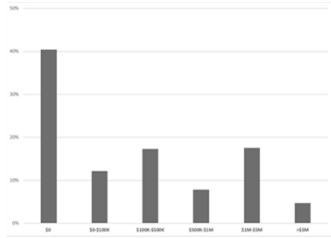
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**FREQUENCY OF REPORTED INCOME RANGES  
RECEIVED FROM EQUITY LIQUIDATIONS (2005-2015)**



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Which alternatives most likely fit your deal?

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**“TTO DILEMMA”**

- How can a predominantly passive investor structure an equity investment that is venture-friendly and yet fiscally sound?
- We have done many equity deals, but we have yet to experience enough liquidity events.

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## TRADITIONAL EQUITY LICENSE DEALS

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## STRUCTURE

- License to C-corp;
- 5-15% common equity in lieu of license initiation fee; and
- Anti-dilution protection through Series A round.

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## WHY DID THIS STRUCTURE EVOLVE?

- Lends itself to traditional VC investment structure; and
- Postpones challenge of negotiating \$ value of IP at earliest stage.
  - Instead focuses on relative contribution of IP after Series A.

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## TYPICAL DEAL DOCUMENTS

- Option
- Term Sheet
- License
- Consulting Agreement
- SRA
- Stock Purchase Agreement
- Stockholders' Rights Agreement
- Certificate of Incorporation

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## COMMERCIALIZATION RISKS

- Scientific/technical
- Management
- Regulatory (binary)
- Financial
- Intellectual property
- Market

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## OTHER PEOPLE'S MONEY, INC. INITIAL CAPITALIZATION (in Millions)

Holder	Common Stock	% Of Class	Preferred Stock	% Of Class	Total Issued (\$M)	% Of Total Issued (\$M)	Options and Warrants	Total Stocked	% Of Diluted
Founders	4.5	75%	—	—	4.5	50.0%	—	4.5	45%
Venture Fund	—	—	3.0	100%	3.0	33.3%	—	3.0	30%
University	1.2	20%	—	—	1.2	13.3%	—	1.2	12%
Professor	.3	5%	—	—	.3	3.3%	—	.3	3%
Option Plan	—	—	—	—	—	—	1.0	1.0	10%
TOTAL	6.0	100%	3.0	100%	9.0	100.0%	1.0	10.0	100%

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### TERM SHEET ROLE

- Benefits
  - Set expectations for license and equity structure
  - Save time and money negotiating key business terms
  - Anchor negotiation of definitive documents
- Significance
  - Key business terms are negotiated and locked in at Term Sheet stage

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### CRITICAL DEAL TERMS

- Crown jewels of liquidity:
  - Anti-assignment restrictions;
  - Redemption rights;
  - Tag-along (co-sale) rights; and
  - Lockup limitations.

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### ANTI-ASSIGNMENT RESTRICTIONS

- Found in the License Agreement
- Need to broadly cover all M&A activities
- Need to protect University from unwanted assignees
- Right to consent = leverage
- Potential royalty monetization

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**REDEMPTION RIGHTS**

- Found in either Stock Purchase Agreement or Stockholders Agreement
- Triggers
  - Default under stock documents
  - Default under License (gives University another threat)
  - Passage of time or failure to meet milestones
- Pricing?
- Timing of Payment(s)?

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**TAG-ALONG (CO-SALE) RIGHTS**

- Found in either Stock Purchase Agreement or Stockholders Agreement
- Creates another opportunity for either liquidity or leverage

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**LOCKUP LIMITATIONS**

- Found in either Stock Purchase or Stockholders Agreement
- What is a lockup?
- Why does it matter?

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### PECKING ORDER: WHO CAN SELL AND WHEN

- Open market purchasers
- Small stockholders
- Option holders
- Major stockholders
- Directors & management team

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### OTHER KEY TERMS

- Pre-emptive (Participation) right;
- Piggyback rights; and
- Drag along rights.

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### PLAN TO RENEGOTIATE: CARROTS & STICKS

	CURRENCY	THREATS
Univ	<ul style="list-style-type: none"> <li>• Improvements</li> <li>• Future technology rights</li> <li>• Contract concessions</li> </ul>	<ul style="list-style-type: none"> <li>• Collection of past due amounts</li> <li>• Termination</li> <li>• Re-licensing to competitor</li> </ul>
Comp	<ul style="list-style-type: none"> <li>• Cash or equity</li> <li>• Improvements</li> <li>• Contract concessions</li> </ul>	<ul style="list-style-type: none"> <li>• Payment default</li> <li>• Abandonment of technology</li> </ul>

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### FRUSTRATIONS AND FRICTION POINTS FOR THE TTO WITH TRADITIONAL EQUITY LICENSES

- Management and its counsel lack experience doing university deals
- Valuation and deal structures don't necessarily go hand in hand
- University inventor(s) can be on both sides of the deal
- A whole lot of planning and contingency goes into something that is very unlikely to happen for the average university startup (e.g., an exit)

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### ALTERNATIVE DEAL STRUCTURES

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### LLC's

- Different and more complicated documents;
- UBIT risks enhanced under new tax law;
- Prohibition on lobbying activities; and
- IRS rulings and internal policies on JV's.

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### CONVERTIBLE DEBT

- More complicated structure than it seems in concept; and
- Requires \$ valuation of IP at closing.

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### WARRANTS

- Adds additional layer of complexity;
- Avoids tax issues of LLC structure until exercise; and
- Need cashless exercise feature.

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### QUASI-EQUITY (PHANTOM EQUITY)

- Contract right to a portion of Company appreciation; and
- Company pays University.

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### SIMPLE AGREEMENT FOR FUTURE EQUITY "SAFE"

- Used for angel investing
- U receives preferred equity upon future financing trigger
- Need to negotiate discount and/or valuation cap and cash value of IP
- Company does not come out of pocket to pay U

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### FACILITATING THE EXIT

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### PARAMETERS

- When does equity or proceeds get distributed to inventors?
- Who manages equity portfolio for TTO?
- When does University equity position get liquidated?
- Insider trading safe harbor.

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# STREAMLINING DEAL MAKING

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**STEPS (Part 1)**

- Develop an approach that includes must haves for the University but is mindful of concerns investors will raise about financials and governance
- Keep the structure simple
  - If an investor can't pick it up, read it and get it in a first pass, it's likely too complicated

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**STEPS (Part 2)**

- Use Term Sheets!
  - Keep everyone focused on the big picture items in the deal and reach agreement before getting down in the weeds
- Develop and use equity documents that already contain all of the terms your University will want to see

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## NEXT WAVE

Advanced equity program being presented  
at upcoming AUTM Eastern and Western  
Regional Meetings

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## ADDITIONAL RESOURCES

- The Technology Transfer Law Handbook: <https://shop.americanbar.org/ebus/store.aspx?term=The+Technology+Transfer+Handbook>
- SAFE blog: <https://www.mkbattorneys.com/blog/early-stage-companies-better-off-safe>

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Thank You

Who has the first question?

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## **DISCLAIMER**

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