



Guideline for the IP Agreement Process with Spin-Offs

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in co-operation with Bundesverband Deutsche Startups e.V.

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1. Introduction

Innovative spin-off companies from universities and research institutes (referred to collectively in this document as “scientific institutions”) play a crucial role in transferring research results into a commercial setting and contributing to economic and social progress. Moreover, scientific institutions can make an important contribution to value creation by founding new companies as they bring new, high-quality jobs to the region and beyond.



Figure 1: exploitation of IP through a spin-off company

However, the exploitation of intellectual property (e.g., research data, copyrights, industrial property rights) by means of a spin-off often poses difficulties for both the scientific institution and the individuals involved in creating the company. This is due to the fact that the probability of success is difficult to predict and there are many uncertainties associated with founding a company. Moreover, in cases where the inventors (or holders of relevant know-how) are also part of the founding team, it is rarely possible to exploit the IP in any other way than through the spin-off. In their new role as entrepreneurs, however, the prospective founders are driven by interests that differ from those of the scientific institution. On the other hand, exploiting IP and taking a stake in start-ups usually have very positive effects on the public perception of the scientific institution – and, under the right conditions, can even turn out profitable. To make those IP transactions as quick and smooth as possible for all parties involved, a well-structured and transparent procedure is required.

The process of licensing or transferring IP rights to a spin-off company is typically characterised by a number of features that differ from IP exploitation in established companies:

- The start-up teams may (especially in the early stages) be inexperienced with regard to IP transfer and some might still be employed by the scientific institution.
- The scientific institution may be inexperienced in working with start-ups.
- There may be conflicts of interest or conflicting roles both within the start-up team and within the scientific institution.
- The process often has to start even before the company has been formally spun out and before certain important parameters have been finalised entirely.

- Compensation elements in line with market standards, such as up-front payments and minimum licence fees, can pose major challenges for start-ups in their early stages (usually lacking an income), as recurring payment obligations that are not related to market success make start-ups less appealing to investors, and therefore increase the risk of insolvency.
- The large number of stakeholders can come along with diverging interests that are often complex and non-transparent.

All parties involved should be aware that the aim of the negotiations must be to bring about a successful conclusion and achieve a result that is acceptable for both sides.

2. Problem and objective

The characteristic features outlined above often lead to uncertainty among all actors involved in the process, causing negotiations to last longer than necessary and often giving rise to criticism.

In order to minimise this additional factor which can hinder a start-up's development, the IP exploitation process has to be as transparent as possible for everyone involved. Throughout the process, a high level of transparent and open communication between the various stakeholders should be ensured. A working group on spin-off creation and equity management at *TransferAllianz* has developed these guidelines in collaboration with representatives of *Bundesverband Deutsche Startups e.V.* with the aim of describing the aspects and standards needed to make the IP exploitation process as smooth and successful as possible. These guidelines are primarily intended as practical and organisational recommendations for scientific institutions with few spin-off cases so far and for founders with little experience in IP transfer.

This document will not elaborate on the ideal terms and conditions or common ways in which IP agreements can be structured. Instead, it focuses on the shared path towards the conclusion of an IP exploitation agreement. The resulting IP exploitation agreement should be structured in a way that is both in line with market standards and "start-up-friendly"¹.

3. Stakeholders in the exploitation process

One of the characteristics that makes the IP exploitation process so complex is the fact that there are many different stakeholders involved, many of whom exhibit conflicting interests and demands. In addition, as described above, some stakeholders hold multiple roles throughout the process. The four most important stakeholders are presented schematically in the overview below. A crucial role is assigned to the transfer office – within the scientific institution itself or externally on its behalf – which carries out the commercial transfer of intellectual property in accordance with the requirements stipulated in public law. The transfer office is usually responsible for coordinating the various stakeholders involved in the process.

It is not surprising that all stakeholders have the same basic interest, i.e. to launch a successful spin-off company. However, some may also have very different, competing secondary interests.

¹In this context, "start-up-friendly" means that an IP agreement should not contain early fixed payments (up-front or minimum payments) or that such payments should be kept low and stretched over time or deferred so as not to overburden the start-up's low liquidity.

The scientific institution is obliged to comply with budgetary and state aid rules and to document how the agreed remuneration has been calculated; it is not allowed to grant its own spin-off companies preferential treatment over third parties.

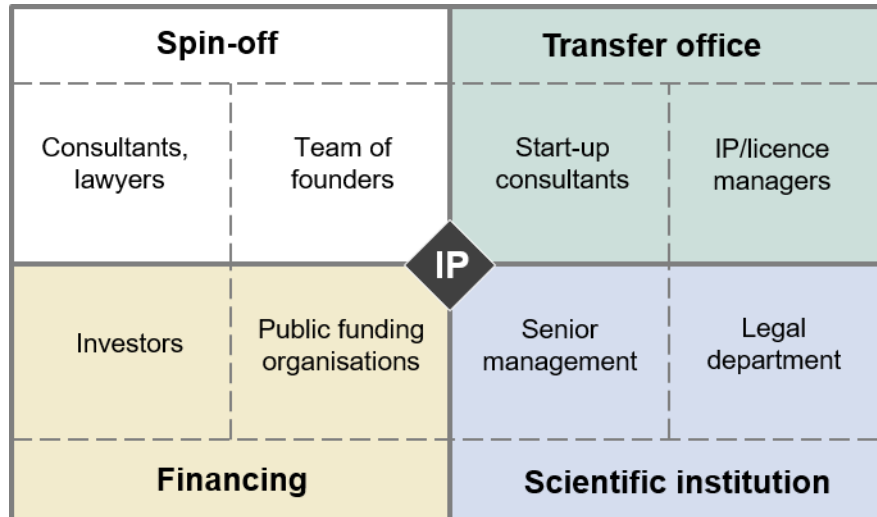


Fig. 2: Stakeholders in the process of IP exploitation through spin-offs

It is important for all stakeholders to be familiar not only with their own interests, but also with those of other parties involved as well as with the underlying legal frameworks. The scientific institution's transfer office or its commissioned transfer agency, respectively, is tasked with the challenge of providing comprehensive and neutral information to avoid unnecessary tensions and misunderstandings from the outset.

4. Basic principles

A good process and, above all, a satisfactory result can only be achieved if the partners adhere to certain basic rules of cooperation. A number of important aspects and rules that the partners should commit to observe are outlined below:

4.1 Common understanding of a strategic partnership (win-win situation)

One aim of exploiting IP through a spin-off company is to establish a long-term partnership between the scientific institution and the newly founded company. For this to work, it is essential that both partners can derive added value from the partnership. In this respect, the negotiations must always take place on an equal footing and result in a win-win situation for both sides.

4.2 Extensive, fact-based communication

Sound, goal-oriented and proactive communication is key to an efficient negotiation process.

Each side should communicate with the other in a respectful, objective, fair, open and transparent manner. Respective negotiating positions should be presented clearly and, if possible, be substantiated by comprehensibly backing up arguments with references and derivations.

In many cases, especially for less experienced start-up teams and transfer staff with little experience in dealing with start-ups, it may be useful to consult external specialists for support. This can help to ensure professional and targeted negotiations. Both parties should openly inform each other if they call in such third parties. External counsellors should then be involved officially in the discussion and negotiation process, provided they have agreed to observe the same basic principles detailed here. This helps to speed up the process and to avoid misunderstandings.

If possible, all important negotiations should be conducted by at least two people representing each side, and minutes should be kept in writing. Any new developments arising over the course of the process that are relevant to the cooperation should be communicated promptly and proactively.

At the start of the negotiations, it is particularly important that the scientific institution seek an in-depth exchange with the start-up involved thus presenting and explaining its existing policies and principles.

4.3 Early transparency regarding the emergence and resolution of conflicts of interest

As the persons involved in negotiations usually have several roles (e.g., university inventor and founder or start-up consultant, negotiation partner for IP agreements and investment manager), various conflicts of interest can emerge on both sides. There are also a number of other compliance issues, e.g., the clear distinction when it comes to the spin-off using infrastructure and personnel in the phase of transition from a project within the scientific institution into a company. One of the most important principles in this regard is to organise the best possible distinction of roles and spheres. This can be achieved, for example, if the scientific institution designates different consultants for supporting the start-up team, on one hand, and conducting the IP negotiations, on the other hand. The institution can also avoid conflicts of interest by making sure that the person negotiating for the start-up team does not belong to the group of inventors involved. If this is not possible or reasonable, the roles and their associated interests should be clearly addressed in advance and the greatest possible transparency should be established with regard to everyone's role in the process.

It is generally advisable to set up a clearing process for the compliance-related assessment of measures that are planned with regard to spinning off the company (e.g., with regard to conflicts of interest and the distinction of roles and spheres).

4.4 Dispute resolution mechanisms

The main aim of the negotiations should always be to bring about a successful conclusion and achieve a result that is acceptable for both sides. Nevertheless, situations can arise in which the interests pursued by each negotiating party are so far apart and so entrenched that an amicable solution seems impossible. In such cases, it is advisable to either count on the support of mediators during the conflict resolution process or to call upon arbitrators. Such external arbitrators can develop a start-up-friendly draft agreement that is binding for both sides and corresponds to market standards after hearing both sides and doing their own research. Mediators and arbitrators should be absolutely independent, impartial and competent persons who are able to act free from any personal interests of their own and who are appointed by mutual agreement of the negotiating parties or by a neutral authority.

The parties should agree beforehand on how the arbitration costs are to be shared out between them.

5. General basic requirements for the scientific institution

As the process of creating a spin-off company is time-sensitive, scientific institutions should establish and communicate their basic rules, processes and responsible personnel in advance to avoid time-consuming discussions on basic issues during the phase of preparing the formation of any particular company. As a minimum requirement, every institution should possess an IP policy and provide a written description of its specific process for granting IP rights to spin-off companies. Both documents should be published in an easily accessible location on the intranet or internet.

5.1 IP policy

An institution's IP policy sets out its own basic rules for dealing with IP. It also includes regulations on how spin-off companies can obtain rights to use IP belonging to the scientific institution.

Here are some of the common questions:

- What general conditions apply to the exploitation of IP through spin-off companies?
- Does the institution take a stake in spin-offs? If so, under what conditions?
- Can ownership to IP rights be transferred? If so, under what conditions?
- To what extent and for how long does the institution cover IP costs?
- How does the institution deal with other competing options to use or exploit the IP that exists or may emerge?
- How does the institution deal with conflicts of interest and conflicting roles? Are there any restrictions for employees when it comes to participating in a start-up?

The IP policy, therefore, is crucial for managing expectations and defining the institution's basic framework for preparing and implementing an IP-based start-up. For this reason, it should be clear, comprehensible and easily accessible for all members of the institution. The scientific institution's transfer office and/or start-up centre should also take on the task of informing start-up teams about the IP policy at an early stage.

5.2 Describing the process of exploiting IP through spin-offs and decision-making

In addition to the IP policy, the institution should clearly outline in a process description information about relevant contact persons and their specific responsibilities as well as a detailed account of each step of the process, starting from the initial attribution of IP to a spin-off project, then moving on to the preparation and creation of the company all the way to the ongoing management of existing IP agreements and any shareholdings. The process description should outline each step and point out the persons who are responsible for making the relevant decisions on behalf of the scientific institution. It should also specify which activities and documents will be needed from both the scientific institution and the start-up team in order to adequately prepare for the process. An indicative time frame should also be specified for each step of the process. Every institution should possess such process description (e.g., as part of a comprehensive guideline to spin-off creation) to avoid any confusion regarding responsibilities and decision-making procedures, and to minimise loss of time which can pose a threat to any start-up project.

As mentioned above, if basic principles are not clarified before they actually arise, this can lead to considerable delays and, as a result, major disruptions and conflicts. However, this does not mean that the specifics of each individual case should not be adequately taken into account during the process.

In addition to the process description, it is advisable to create template documents or use existing templates for each step of the process (e.g., brief description of the start-up idea, memorandum of understanding, term sheet) and to make such documents accessible within the institution.

6. The process of IP exploitation in detail

The following section describes what shape the process of IP exploitation should generally take and what requirements are to be met for each step of the process. It is important to note that both parties should agree on the basic parameters (e.g., team of founders, relevant IP, business model) and their associated tasks and expectations in the early stages of the process in order to avoid subsequent complications, disruptions and considerable loss of time.

Teams of founders and their start-up projects can be at any point across a very broad spectrum in terms of their practical knowledge and the stages of development when entering the process. This spectrum ranges from individuals who are interested in founding a company with little more than a mere business idea to small groups working in state-funded pre-start-up projects that already have a sound and reviewed concept proposal and an initial core project team all the way to teams that are about to launch a start-up based on a fully-fledged business plan, and already hold initial talks with their first investors. Accordingly, the scientific institution and the start-up team may either still have to complete all of the tasks outlined below or they may have already obtained first results in some aspects.

The four core elements of the process (initial IP meeting, memorandum of understanding, term sheet, IP agreement) are introduced and explained below.

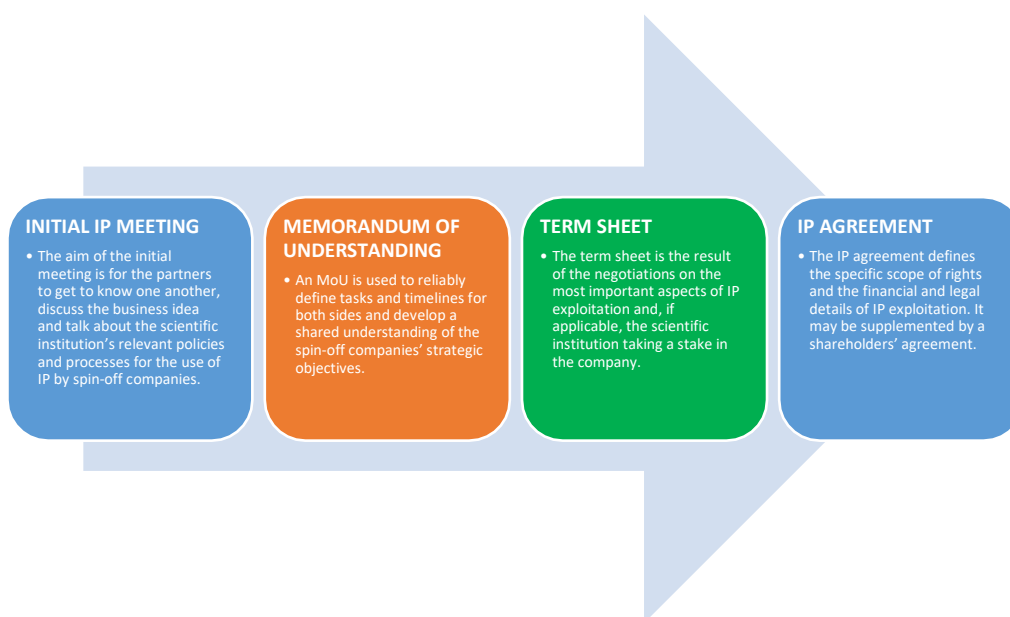


Fig. 3: Recommended process stages for IP negotiations between the spin-off and the scientific institution

6.1 Initial meeting on the use of intellectual property

The aim of the initial meeting is for the partners to get to know each other and to initiate the exchange. Even if the parties are already acquainted with each other from other contexts, they should hold an initial meeting to discuss the planned spin-off company's business idea.

On the one hand, the conversation should include an introduction to the scientific institution's general IP policy, relevant processes and contact persons. The institution's IP policy and process description (see above) should serve as basic documents. On the other hand, the team of founders should present the business idea and outline its current status of implementation. In order to prepare for the initial meeting, it is advisable to draw up a "one-pager" of the business idea, containing information on the team, planned financing, time schedule, etc. A suitable template should be provided by the scientific institution.

During the initial meeting, the partners should also address the following questions: Which IP might be relevant to the spin-off? In which context was the IP created? Are there any contracts already in effect regarding the IP? It should also be discussed which resources of the scientific institution the spin-off company would like to use in the future and whether there are plans to apply for public funding through the institution. As the initial meeting usually does not allow for comprehensive answers to all such questions, it is advisable to compile to-do lists for both sides.

All important aspects discussed in the initial meeting as well as next steps and tasks for each side that were agreed upon should be summarised in writing and sent to the start-up team.

6.2 Process meeting and conclusion of a memorandum of understanding

On the basis of the initial meeting and any remaining points that have to be mutually discussed afterwards (e.g., existing contractual obligations regarding the relevant IP), the scientific institution will decide, based on objective criteria, whether it generally consents to licensing or transferring IP rights to the spin-off company.

If the IP transaction is not to take place immediately, it is advisable for various reasons to create a letter of intent (also known as a memorandum of understanding) outlining the further process of IP exploitation. Here are the two most important reasons:

- 1) It is in the start-up team's interest to ensure that any existing IP that is relevant to their project – and any IP that may be created before the agreement is ultimately concluded – is reserved for the spin-off project. At the same time, this gives the scientific institution clarification as to whether existing IP is likely to be used for the spin-off project or whether it remains free to be exploited by other means. Consequently, it is important for both negotiating parties to gain greater certainty when it comes to making plans involving the IP.
- 2) In addition to the IP, the scientific institution plans to provide further resources (e.g., financing, space, staff) for the further development of the spin-off project.

The aim of a memorandum of understanding is to provide a reliable framework for the further course of working on the spin-off project for a limited period of time. Before drawing up a memorandum of understanding, the following points need to be fulfilled:

- A rough business idea has been developed, which indicates a clear commercial purpose, the planned products/services and target markets, and which appears viable in principle.

- A core team has been put together and financing has been obtained or, at least, a plan exists for obtaining financing in order to manage and fund the next steps and tasks that will arise after the conclusion of a memorandum of understanding.
- The transfer of (exclusive or limited) IP rights is compatible with the general research strategy of the institutes, chairs, inventors etc. involved in creating and using the IP at the scientific institution and with any existing contracts with third parties.

The first two points can be addressed through a presentation by the team of founders or a suitable funding application. If available at the scientific institution, an assessment by the entrepreneurship centre should be included. The third point will usually have to be checked by the transfer office.

The memorandum of understanding should include statements on the following three areas:

- 1) Definition of IP that is relevant to the spin-off project:
The document should state clearly for both sides which existing IP is associated with the planned project and what new IP may be expected in the short term. This should be supplemented by a commitment from the scientific institution to refrain from actively marketing the relevant IP to third parties for a certain period of time.
- 2) The resources to be provided by the scientific institution:
The document should specify the resources to be provided by the scientific institution for the further development of the spin-off project (e.g., infrastructure, personnel, funds, consulting and support services) and what will be expected from the start-up team in return.
- 3) The tasks and responsibilities to be assumed by both sides during the term of the memorandum of understanding and the relevant timetable, typically including the following information:
 - If not yet provided, a definition of the required IP and the necessary scope of rights (type of use rights, field of application, geographic scope);
 - Clarification of IP ownership rights and their dependencies (e.g., basic patents, biological material or software);
 - Analysis of the relevant IP landscape (qualitative, not a legally binding freedom-to-operate analysis);
 - Development of an IP strategy;
 - Development of a business model and the envisaged revenue streams;
 - Creation of a financing model and a plan of how to approach investors (if applicable);
 - Plan for the (initial) validation of the business model with defined milestones;
 - Definition of the further process of technical development with associated milestones;
 - Description of the current team and strategy for completing the required set of competencies;
 - Overall schedule up to formal company creation (incl. requirements and schedule for the IP agreement).

The memorandum of understanding should make specific reference to the results and milestones that are to be achieved by both sides before the term sheet is created. One important milestone is usually the development of a promising, viable business model.

During this phase, the focus of activities to be performed lies with the start-up team, as only they know the business idea and all the resulting requirements in detail. The more precisely the start-up team defines the core of their future business and which IP rights are necessary for its implementation, the sooner the process can advance.

6.3 Creation of a term sheet

The purpose of the term sheet is to underline the key economic considerations related to the planned transfer of IP rights in preparation for the drafting of the actual agreement. Instead of a term sheet, the parties may consider to conclude an option agreement for a limited period of time which can be extended, for example, after predefined milestones have been reached. An option agreement or term sheet can also be helpful or even necessary for the start-up team when talking to investors.

Before entering term sheet negotiations, the following preconditions should be met:

- Availability of a business model to be pursued by the start-up team, including statements on products and their fields of application, a sales and revenue model, and sound financial planning;
- An assessment by the scientific institution which states that the business model is generally considered commercially viable and promising;
- A level of development of the spin-off project that indicates a high likelihood that the company will soon be able to enter the market or obtain financing;
- Presence of the core members of the start-up team who are capable of handling the tasks that will come up at the point of launching the company;
- Clarification of the ownership rights to the IP in question and a completed examination of whether and, if so, to what extent the usability of the IP is restricted by contracts with third parties, funding regulations, etc. or whether the use of the IP is subject to certain conditions.

If these and any other defined requirements for the creation of the term sheet are met, some of which may be specific to the scientific institution involved, the partners can start negotiating the term sheet conditions. The scientific institution will usually develop an initial draft. The term sheet includes the essential conditions for the IP licence or, if applicable, the transfer of IP ownership. This not only requires the careful examination of data available from similar deals, but also an assessment of the IP in terms of its scope of protection and its enforceability. Comparable conditions may, for example, be derived from licence databases, information from court judgements and settlements reached by arbitration boards, as well as from published terms and conditions of earlier deals.

The parties may also wish to consult external reports (e.g., by patent attorneys regarding the scope of protection or by management consultants or auditors regarding the valuation of IP). The way in which the initial offer has been devised should be presented as transparently as possible, including the sources of the data used.

Here are some of the typical components of a term sheet:

- Definition of the IP relevant to the agreement;
- Type and scope of the use rights or, if applicable, of the transfer of IP ownership;
- Type and amount of financial compensation;
 - Definition of the valuation base (proportion of scope of protection for the product in case of sales or licence payments);
 - Amount of possible up-front payment, definition of payment-triggering milestones and amount of milestone payments (if applicable), amount of a minimum licence fee and other financial components;
 - Type and amount of the scientific institution's stake to be taken in the company (if foreseen);
- Arrangements on the assumption of further patenting costs;

- Arrangements on dealing with subsequently emerging IP, possible limitations affecting the IP or the non-granting of patents.

The term sheet should contain standard market conditions for IP rights, but the terms of use or transfer of ownership, should be designed as start-up-friendly as possible. A “start-up-friendly” approach means to largely do without fixed payments, which have an adverse effect on the young companies’ liquidity. Instead, higher royalty payments based on sales and/or taking a stake in the company are possible ways to compensate for forgoing fixed payments in light of the start-up’s liquidity.

The term sheet should cover all essential economic and legal elements, but it should not be too extensive. The term sheet may be concluded in a non-binding manner in order to keep the formal closing process short and simple. Although the term sheet is often non-binding, it is common practice to strictly adhere to the key points negotiated and not to deviate significantly from them without good reason when drafting the actual IP agreement.

Depending on the responsibilities and decision-making procedures within the scientific institution, it may be reasonable to informally involve the senior management and possibly additional stakeholders at this stage in order to address potential questions early on.

6.4 Conclusion of the IP agreement

Based on the term sheet, unless significant uncertainties remain, the scientific institution can usually draft the IP agreement in a relatively short period (approx. six weeks). The key points contained in the term sheet are further specified and converted into comprehensive contractual clauses. Some important additional clauses may, for example, relate to an obligation for the licensee to actually exercise the rights, the specific financial arrangements, patent management, liability and indemnification obligations, and termination rights. If financial relief is sought in the early stages of the company, the IP agreement may contain additional aspects, e.g., that the scientific institution take a stake in the spin-off company if this seems appropriate. The IP agreement should be drafted by legal staff with relevant experience and will have to be adapted to each spin-off project’s specific features. It is also advisable for the start-up team to seek advice from experienced contract lawyers and, if necessary, patent attorneys.

6.5 Scheduling

It is almost impossible to specify how long it should take to run through the entire standardised process, as there are a range of individual factors that may arise in specific situations. Spin-off projects often undergo volatile phases and are influenced heavily by, for example team changes, new results in technology development, new findings on the market situation, or changes in funding plans.

Ideally, in cases where the scientific institution has a transparent policy and the spin-off company finds itself in a stable situation (incl. financially), a maximum of four weeks should suffice to pass each of the outlined stages of the process. Thus, it should be possible to conclude an IP agreement in three to four months in total. For this to work, both sides have to communicate openly and transparently, and any substantial negotiation proposal from the other party should be responded to within two weeks.

In cases where the scientific institution becomes a shareholder in the spin-off company, other bodies outside of the scientific institution may need to be consulted; this has to be considered and communicated on a case-by-case basis (see 6.1: “Initial meeting on the use of intellectual property”).

7. Conclusion

The exploitation of IP through a spin-off company is a challenging and complex process; the duration and success of the negotiations is heavily dependent on stringent and transparent process design and sound communication between the partners. Scientific institutions should lay the necessary foundations by developing and implementing an IP policy, process descriptions and, where appropriate, document templates. On the part of the start-up teams, it is necessary to lay down their requirements regarding IP rights early on and to provide a comprehensible economic outlook for their business idea as a basis for negotiating the financial conditions.

It is recommended to base the process on four elements (initial meeting, memorandum of understanding, term sheet and IP agreement), and to ensure that the tasks and responsibilities to be assumed by both sides as well as a corresponding timetable are clearly specified during each stage of the process.

Other issues, e.g., compliance aspects and conflict management, should also be discussed in an open and transparent setting right from the outset. It is advisable to use alternative dispute resolution methods, such as mediation or arbitration, where necessary.

The aim of all negotiations should always be to achieve a win-win situation, i.e. an agreement that is in line with market standards but at the same time start-up-friendly. In this regard, it is essential to have an open and fair negotiation process in which both parties are on an equal footing, as outlined in these guidelines.