ISSUES TO CONSIDER IN A NEW VENTURE SPIN-OUT

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I. Reasons for Spinning Out

A. Free the venture from parent's resource allocation and planning decisions and other constraints, which may not be consistent with health and growth of venture

B. Different risk profile - hard to justify investment in new market compared with familiar, existing business

C. Liberate parent from funding responsibilities

D. Encourage entrepreneurial spirit; increase focus

E. Recruit talent that might not be attracted to internal division or venture

F. Employee ownership

II. Technology Transfer Structure

A. Assignment vs. license

B. License

1. Exclusive vs. nonexclusive

2. Field of use

3. Retention of rights by parent; License back to parent for certain uses

4. Infringement by third parties; Infringement on the rights of third parties

5. Improvements

C. Ownership issues if continued joint development

III. Economic Terms

A. Contributions by parent

1. Intellectual Property

2. Valuation of the Intellectual Property

a. Function of R&D expense attributable to the technology

b. Function of valuation of technology if sold currently to a third party

c. Negotiation with outside investors

d. Equity vs. Royalties. Create a "win-win" structure. Consider use of convertible preferred stock with liquidation preference equal to agreed upon current value to preserve cash in the venture

e. Use of milestones to adjust consideration to parent (conversion ratio adjustment or issuance of Warrant) subsequently if value is ambiguous

3. Other assets

a. furniture, fixtures or equipment

b. intangible/contracts

c. infrastructure services (HR, accounting, etc.)

d. temporary facility sharing

4. Financial support - seed financing; follow on funding; commitment to participation in later outside financing round(s)

B. Contribution by new investors (generally cash for preferred stock)

C. Equity participation by management -- Individuals treated as founders?

D. Continuing commercial relationship between parent and new venture

1. Vendor/Customer

2. Support services

3. Joint R&D

E. Competition between parent and new venture

1. For customers

2. For employees

IV. Governance

A. Constitution of Board of Directors

1. Parent represented

a. Director

b. Observer

2. Management represented

3. Outside investors represented

4. Procedure for selecting independent directors

B. Protective Provisions (voting, special consent rights of parent, etc.)

1. Parent

2. Outside investors

V. Different Approaches in Commercial and Academic Contexts

A. Economics

1. Equity allocation

2. Royalties

3. Sponsored research

B. Governance

C. Ongoing relationships

VI. Conflicts of Interest

A. Parties:

1. The parent

2. The new venture

3. Outside investors

4. Management/founders

5. In the university context - add the academic institution and the faculty member/principal investigator

B. Parent on both sides of transaction

1. Watching out for interests of new venture

2. Watching out for interests of management

3. Are interests naturally aligned?

C. Impact on employees of new venture

1. Can they effectively negotiate?

2. Potential negative impact on future success of venture?

3. Consider designating roles (i.e., founder/management to look out primarily for interests of Newco, even though still employed by parent, and parent executive to look out primarily for interests of parent)

VII. Human Issues

A. Who goes with Newco? Who stays with parent?

B. Can parent tolerate loss of talent?

Alternative arrangements (allowing parent to keep people)

1. Compensation/incentive issues

2. Accentuated conflicts of interest