

## **INTELLECTUAL PROPERTY MANAGERS CONTRACT AND GRANT OFFICERS VICE CHANCELLORS – RESEARCH/ADMINISTRATION**

**SUBJECT:** Non-Exclusive Royalty-Free Invention Rights (NERF) Pilot Program

### Background

University-industry relations engage a diverse mix of companies – ranging from start-ups to industry giants in diverse fields such as biotechnology, pharmaceutical, and electrical engineering – each with a unique set of market strategies and intellectual property requirements. While the University must ensure that its research relationships with industry support the University's education, research, and public service missions, the University must also be flexible and open to the diverse range of industry sectors and the associated and sometimes changing needs of each.

Certain industry sectors invest heavily in the long term development of commercial products (i.e., pharmaceuticals and start-ups). The successful development of such products is often predicated on the business principle of exclusive access to the underlying technology and establishing an exclusive position within the marketplace that excludes the competition. On the other hand, successful product development in other industry sectors require rapid prototyping and early market entry, and are typified by short product lifecycles. Operating within this framework, such sponsors typically are not interested in any advantages resulting from exclusive access to University-owned intellectual property. Instead, they require the freedom to operate afforded by royalty-free, non-exclusive licensing rights. The same market principles also apply to companies that may hold a proprietary position in the market by way of protected resources (i.e., biological materials, compounds, drugs, proprietary processes, etc.) but seek to improve their market position by sharing their proprietary resources with the University under collaborative research projects. As the University strives to enrich its interactions across the full spectrum of industry sectors in activities that fulfill the University's education, research and public service missions, it must sometimes evaluate new approaches to such endeavors.

### NERF Pilot Program

The University conducted such an evaluation with respect to industries in the electrical engineering and computer science fields, resulting in the introduction of the EECS Pilot Program in August 2000 (extended indefinitely in 2003). Similarly, this NERF Pilot Program is designed to accommodate the needs of a wider cross-section of industry sponsors of research given the success of the EECS Pilot Program. The NERF Pilot Program provides University Contracts & Grants offices greater flexibility in negotiating rights to University inventions made in the performance of a sponsored research agreement across a wider range of industry research sponsorship.

### NERF Pilot Program Authority

The range of options available to authorized Contract & Grant Officers is articulated in existing University policy as implemented under the University Contract and Grant Manual, Chapter 11-341, "Summary of Sponsor Patent Rights Applicable to Funding Agreements With Industrial (For Profit) Sponsors of Research," including committing a right to royalty-bearing exclusive and non-exclusive licenses to for-profit research sponsors. This range of options is hereby expanded to include the authority to grant a for-profit sponsor the first right to negotiate a royalty-free, non-exclusive (research or commercial) license to the University's interests in patentable inventions conceived and first reduced to practice in the performance of a research project in accordance with the guidance below. The NERF Pilot Program authority extends to University of California Contract and Grant Officers (C&G Officers) and others with the delegated authority to enter into sponsored research agreements with a for-profit sponsor of research on behalf of the Regents.

This NERF Pilot Program authority must be applied in a manner consistent with the University Policy on "Principles Regarding Rights to Future Research Results in University Agreements with External Parties" (Enclosure A) and the NERF Pilot Program guidelines discussed below. In applying this authority, it is important that C&G Officers consult with all stakeholders, including their authorized Campus Licensing Office<sup>1</sup>(CLO) and University project participants, who on a case-by-case basis, should participate in and take responsibility for decisions concerning the use of the NERF Pilot Program authority. The NERF Pilot Program authority may be applied to for-profit sponsorship of University administered research activities that otherwise follow standard University intellectual property policies, including the Discovery Grant Program, the UC-MICRO Program, and CISI programs. In addition, each campus/Laboratory, at its discretion and working with the relevant offices (C&G, CLO, Vice Chancellor for Research, etc.), may implement additional local restrictions and approval requirements that meet the specific needs of the campus/Laboratory when implementing the NERF Pilot Program authority.

Please note that the University's starting point in its negotiation of a sponsored research agreement should generally continue to be a first right to negotiate a royalty-bearing license, especially since many sponsors have well established, long-standing relationships with the University under this business model. In most cases, the sponsor's interest can and should be readily accommodated under such standard intellectual property arrangements.

The NERF Pilot Program authority is issued for immediate use and extends through September 30, 2010. The results of the NERF Pilot Program and the appropriateness of any renewal will be assessed at that time. Additional guidance on factors to consider when exercising the NERF Pilot Program authority is provided in Enclosure B.

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<sup>1</sup> CLO is the campus/Laboratory-based office that has received formal reassignment of intellectual property licensing authority from the Office of the President, or the UCOP Office of Technology Transfer, as appropriate.

## Guidelines for Negotiating Invention Rights Provisions with For-Profit Sponsors Under the NERF Pilot Program

Sample contract language consistent with the NERF Pilot Program authority is provided in Enclosure C for consideration when developing intellectual property rights provisions under the NERF Pilot Program authority. C&G Officers, however, are not restricted to using only the sample provisions provided in Enclosure C.

Any agreement that grants licensing rights to a for-profit sponsor under the NERF Pilot Program authority must conform to the University Policy on "Principles Regarding Rights to Future Research Results in University Agreements with External Parties". C&G Officers, in consultation with their CLO, need to consider the following key elements of these Principles when exercising the NERF Pilot Program authority:

1. PUBLIC BENEFIT – It is the responsibility of the University to ensure that future research results be diligently moved to the marketplace for the public good.

The key consideration here is whether the commitment of a NERF restricts the University's ability to ensure that the public interest is served. For example, if a company is unable or unwilling to develop a technology under the NERF license, the campus must ensure that such inaction does not undermine the public interest. This is arguably inherent in a technology sector that does not rely on exclusivity. Otherwise, one way to ensure the public interest is served would be to require diligent performance by the sponsor for timely commercial development and marketing of any licensed inventions. However, there may be certain, limited circumstances when a license agreement obligation for such diligent performance may not be applicable. Examples include when the sponsor desires only access to the technology for internal use for research and development purposes on a non-exclusive basis, and when other licensees would be able to ensure diligent movement to the marketplace. Another approach would be to limit the NERF to a field of use that is already dominated by the sponsor's proprietary technology, and is thus unavailable to other companies. The campus' or Laboratory's CLO should evaluate the circumstances surrounding the nature of the technology and the marketplace, the sponsor's intended use, and the commercialization plan for the technology before exercising judgment in this area. This determination typically cannot be made until after an invention has been disclosed and evaluated by the University, unless the scope of such invention can be pre-defined at the time the research agreement is negotiated. Thus, it is usually appropriate that the University's right to require diligence at the time of licensing be preserved in the research agreement.

## 2. LEGAL INTEGRITY AND CONSISTENCY

- a. Obligations must enable the University to satisfy its agreements with third parties, including the Federal government.

C&G Officers must ensure that they do not inadvertently enter into conflicting contractual obligations with other parties when exercising the NERF Pilot Program authority (i.e., granting NERF license rights to one sponsor and exclusive license rights to another sponsor for the same invention). Commitments concerning future research results made under the provisions of the NERF Pilot Program must be consistent with all applicable laws and regulations and the University's contractual obligations to third parties.

- b. Obligations of the University must be consistent with the requirements of the Tax Reform Act of 1986, where applicable.

C&G Officers must ensure that sponsored research agreements comply with the safe harbor provisions of the Tax Reform Act of 1986. While specific guidance regarding this subject was issued under OTT Operating Guidance Memo 00-01 in May 2000, the Internal Revenue Service (IRS) recently updated the safe harbor provisions for basic research agreements with the issuance of Revenue Procedure 2007-47 (see Information Letter dated August 1, 2007). While a NERF license to a single sponsor of research now falls within the boundaries of the IRS safe harbor, the pre-negotiation of any financial terms of a license – including financial consideration other than a running royalty payable under a NERF license – before an invention is made *may* put the research activity outside the IRS safe harbor provisions, thereby subjecting the research activity performed at the University to private business use limitations and restrictions. The act of offering a sponsor the first right to negotiate a NERF under the provisions of a research agreement is not considered pre-pricing the technology and is consistent with the revised IRS safe harbor provisions. Including specific financial terms (such as pre-defined license fees, license maintenance fees, or financial caps on the total amount to be paid by the sponsor for the license) may put the research activity outside the IRS safe harbor, depending upon the facts and circumstances of the situation. The C&G Officer should consult with their CLO and UCOP/OTT in evaluating any Tax Act implications when a sponsor insists on including specific financial terms or limitations as part of the exercise of the NERF Pilot Program authority.

- 3. INFORMED PARTICIPATION – Informing each University project participant and affected administrative offices of the potential lack of licensing income for any grant of rights to a royalty-free commercial license.

The University's Patent Policy requires all employees to disclose and assign to the University any inventions and patents that are conceived or developed while employed by the University or generated during the course of utilizing any University research facilities or research funds received through the University. In exchange, the University agrees to share a percentage of net royalty income, if any, received by the University through the licensing of any such inventions and patents. University employees engaged in the performance of research governed by an agreement with an external party should have access to and understand the conditions contained in the agreement related to the disposition of future research results.

The grant of royalty-free license rights to a sponsor under the NERF Pilot Program authority would contractually commit the University to a non-standard intellectual property arrangement. Under such circumstances, C&G Officers should ensure the informed participation of all University project participants, including research staff and students, indicating their understanding of the potential impact this arrangement may have on any future royalty income expected from the licensing of any inventions that may result from their performance of work under the sponsored research project. In addition, the exercise of the NERF Pilot Program authority could also impact the campus share of any future royalty income expected under such licensing arrangements. Since the campus is also forgoing any license income that it would otherwise expect, the campus informed participation process should include the appropriate senior management affected by the exercise of the NERF Pilot Program authority (i.e., Vice Chancellor for Research) either on an overall program implementation by the campus or on a case-by-case basis.

4. FAIR CONSIDERATION – The responsibility of the University to obtain fair consideration for the grant of a commercial license.

The University, as a public trust, has a responsibility to manage its assets for the public benefit. Therefore, the University has an obligation to receive fair consideration in exchange for the grant of commercial licensing rights to a sponsor. The level and form of fair consideration should reflect the relative risks and rewards of the commercial pursuit. Such consideration may vary widely based on case-specific factors that include the reimbursement of the University's patent costs, payment of a license issue fee, applicable running royalty payments, an annual license maintenance fee, sublicensing fees, equity, or other forms of consideration (other than financial).

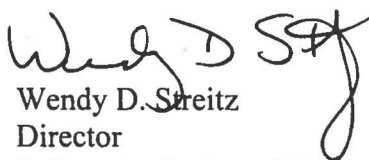
Under the authority of the NERF Pilot Program, C&G Officers can, in consultation with the CLO and University project participants, determine the basis for appropriate consideration, financial or otherwise, under a specific sponsored research project. One possible option could include the right for a sponsor to negotiate a non-exclusive commercial license with no running royalty, but with some other form of consideration, such as periodic fees. Any such determination of fair consideration should be based upon the specific set of circumstances and should be consistent with the other elements of the University Policy on Principles Regarding Rights to Future Research Results in University Agreements with External Parties as well as OTT Operating Guidance Memo No. 00-05, University Licensing Guidelines (December 1, 2000). It is important to emphasize that the rationale used by the campus/Laboratory in determining the appropriate fair consideration for each sponsored research project should be documented in the appropriate University files.

In those situations where a sponsor insists upon defining the form of fair consideration under the provisions of a sponsored research agreement, C&G Officers must obtain approval from their local CLO before including any such provisions in the sponsored research agreement.

If you have any questions concerning the NERF Pilot Program or its implementation, please contact Chuck Rzeszutko.

Refer questions to: Chuck Rzeszutko  
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Sincerely,



Wendy D. Streitz  
Director  
Policy, Analysis and Campus Services

Enclosures:

- A. Principles Regarding Rights to Future Research Results in University Agreements with External Parties
- B. NERF License Rights: Factors to Consider When Exercising NERF Pilot Program Authority
- C. NERF Pilot Program Sample Intellectual Property Rights Provisions

cc: Executive Director Tucker  
Acting Director Deetz, ANR  
OTT Directors  
University Counsel Simpson  
PACS Technology Transfer Officers  
Coordinator Archer