

You and the Big U:
Protecting Your Interests and Your Name
Conflict-of-Interest Considerations
in Spin-off Licensing

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Conflict-of-interest considerations in spin-off licensing with universities can be complex and troublesome for both the entrepreneur and the institution. If the mechanisms for acknowledging and safeguarding against the conflicts in a licensing situation are inadequate, the entrepreneurs and their financial backers are at considerably more risk than the licensing university. For this reason, the issue should receive careful and thorough attention from both sides and should not be regarded as solely the province of the licensor. Entrepreneurs may be impatient with -- or insulted by -- conflict-of-interest safeguards proposed by institutions. But it is the entrepreneur who has the most to lose if problems arise with respect to the spin-off arrangement; as a simple matter of self-interest, no-one should enter into such arrangements without a thorough understanding of the possibilities, risks, range of protective mechanisms, and public appearance of spin-off licenses. The more informed and active both the entrepreneur and the backers of the spin-off firm are in the establishment of protective mechanisms, the better off everyone will be.

What Is Conflict of Interest?

Conflict of interest has two distinct components -- conflict of interest, which most often involves money, and conflict of commitment, which most often involves time. Conflict of interest exists whenever an individual's personal ties could unduly influence a professional judgment. Conflict of commitment exists when an individual's primary loyalties are in doubt. Both types of conflict are part of the territory when a university invites the spirit of entrepreneurship into its midst. Universities are institutions that purport to serve the public good, while entrepreneurs, by definition, are interested in private gain. It is by no means a given that these interests are mutually

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exclusive. In fact, it is the large area of convergence between the public good and private interest that has made these kinds of arrangements so appealing to investors, to institutions, and to society at large.

The possibility of such conflicts is not new to universities, and is not unique to spin-off situations. Other activities may cause similar concerns, yet universities have learned to live the ambiguities of these relationships because they are seen to carry benefits that outweigh their risks. For example, corporate sponsorship of research, corporate licensing of university technologies and consulting activities of faculty all may give rise to difficult situations where the appearance of conflict could become problematic. Policy approaches to these more familiar kinds of arrangements, as well as to the newer questions raised by spin-offs, are still evolving at research universities, as administrators strive to find ways to balance their benefits and their risks.

Is a Spin-off Worth the Risks?

Scholars who go into business for themselves, with a goal of capitalizing on ideas they had while working for a university, first must decide whether they wish to continue their affiliation with the institution. If the faculty inventor and the university choose to go their separate ways, many of the risks are mitigated, but valuable assets also are sacrificed. Conflict of interest becomes much less likely; at the same time, the university may lose the services of a vibrant, engaged researcher and scholar, with whom future generations of students will not have the opportunity to interact. Further, university academic and research programs in the area from which the product emerged may be diminished, if members of the principal investigator's group leave, either to join him or her in the private sector or to find another academic home. This could make it more difficult to attract graduate students and other faculty and staff. Another consideration is the nationwide environment for university research: it is a fact of life in the 1980s that some of the most sophisticated and best-respected universities are setting policies that permit their faculty and staff to engage in entrepreneurial activities. Institutions that are unwilling to embark upon these kinds of ventures

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will be restricting the pool of scientific and technological talent from which they may draw for their faculty and staff.

The faculty member who leaves the university under these circumstances sacrifices the collegial relationships that were probably significant factors in his or her decision to choose the academic life in the first place. The interactions with other faculty, as well as students and staff, may well have provided the impetus for the work which led to the marketable work. The university setting offers intellectual freedom largely unhampered by the dictates of the marketplace; this is difficult to find in most corporate settings, particularly struggling new ventures. Especially for tenured faculty, creative leaps may be rendered more possible by the secure base from which a university-based investigator may operate.

Thus, the motivations for both the institution and the faculty researcher may be toward finding ways to avoid irrevocable separation. It is unquestionable that considering a spin-off may be worthwhile for some technologies -- both for the institution and for the entrepreneur.

As institutions that both create and disseminate new knowledge, universities have an interest in seeing technology transferred from the academic laboratory to the marketplace. They also may gain financially -- sometimes in a big way -- from a product developed in their laboratories and marketed by one of their faculty through a spin-off business. Perhaps most important of all, the institution retains the services of the faculty member, who probably has continuing contributions to make through both teaching and research.

The researcher has an opportunity to profit financially from his or her work in a way that is generally not possible otherwise. Participation in the development of a brainchild without losing the opportunity to pursue other research possibilities can be irresistible. For many such individuals, teaching -- in the laboratory as well as the classroom -- also represents a true commitment not easily discarded. The financial risks of the business enterprise may be less daunting from the secure vantage point of a tenured position with predictable, if modest, income.

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If the spin-off has so many attractions and assets for both the institution and the entrepreneur, what is there to discuss? Why doesn't every interested faculty researcher simply decide, with the full support of the institution, to go ahead and put one foot in the business world?

What Is at Stake for the Entrepreneur?

The answer is that the risks of such ventures -- for both the faculty researcher and the university -- go considerably beyond the financial. Such arrangements invariably carry the potential of serious conflicts of interest. The marketable technologies that emerge from university laboratories generally have been developed with public resources, and the profit to be made will largely fall into private hands. While this may serve the best interests of all concerned, including the university and the public, the situation it creates is rife with possibilities for conflict. If conflict of interest (or the mere appearance of it) does materialize, the price to be paid may be a heavy one. No matter what the source of allegations of wrongdoing, the university will be obligated to investigate. Other outside bodies also may be required, or inclined, to investigate -- possible examples include committees of the state or federal legislature; the agencies that funded the original research; the Securities and Exchange Commission, if the question of "insider trading" based on scientific knowledge should arise; and the Attorney General's office. Reputations may suffer through adverse publicity; academic peers may resent the economic success, the attention and the special treatment that the entrepreneur receives; personal financial assets may be placed at risk through civil or criminal complaints.

As allegations of conflict of interest are investigated, even if they turn out to be without substance, the researcher may lose effective access to the laboratory, to students, and to colleagues. Perhaps the highest price to be paid is in non-productive expenditures of time and energy that must be directed toward responding to allegations and answering the questions that may be raised.

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In addition, if the technology is owned by the university (which is nearly always the case), the controversy surrounding conflict-of-interest allegations may be sufficient to cause the university to conclude that the whole venture isn't worth the candle ---or, less drastically, that the venture should be reconsidered or slowed down until the difficulties are sorted out. The mere fact that a university has previously granted approvals for use of its facilities or equipment does not obligate it to continue down this path; members of the administration will be constantly reevaluating these arrangements to ensure that they continue to be in the interest of the institution. Also, it is almost inevitable that some of the individuals who are involved in the decision-making process will leave the institution, and a new hearing, with different judges, may result in a different outcome. These are obstacles that private ventures not associated with public institutions seldom face, and in the extremely competitive world of high technology, the time lost may prove fatal to a university spin-off.

If, on balance, the university administration, the faculty entrepreneur, and prospective financial backers all decide that the venture is worth the risks that attach to it, all of them must give careful consideration to appearances.

How Will It Look?

The benefits to both the institution and the individual entrepreneur may be so clear to those intimately involved in the decision-making process that it may not occur to them that, taken out of context, the decisions might appear to be ill founded. Reporters see themselves as watchdogs for the public. They are, by nature and by training, skeptics, and they are particularly sensitive to the abuse of the public trust and the misappropriation of public funds. In these cases, the appearance can be just as damaging as the reality. If a story about possible wrongdoing appears on Page One of the local newspaper, a follow-up story months later, setting the context or demonstrating exoneration, cannot undo the damage.

It may be difficult for the typical academic scientist, who is equally committed to principles of

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honesty and openness, to understand what could lead a reporter to question his or her motives in commercializing ideas developed with public funds. Nonetheless, it is prudent to expect motives to be questioned, and to be prepared to explain exactly why the course of action embarked upon is the one that best serves the public interest. It is worth noting that most reporters will find unpersuasive the fact that the public institution will profit financially from the arrangement. The question will come back to one of why, if a profit is to be made, the public body should not make all the profit, or why, on the other hand, it is not made available to any interested taxpayer without cost. These questions have good answers; it behooves the entrepreneur and the university to be ready with them, for the questions certainly will be asked.

Beyond the matter of private gain from public funds, reporters or other doubting thomases might question whether commercial interests might affect the educational programs of students at the university; whether they might subvert research agendas; or whether they might constrain the free exchange of scientific information.

In confronting each of these questions, the most important thing to remember is that straightforward, open, honest answers will work best in the long run. Evasion does not succeed for long, although "I don't know" is a perfectly acceptable answer to a reporter's question, if that is the case. It is also acceptable to explain that the answer cannot be revealed, but this is more effective if the reasons for the secrecy can be explained and are comprehensible to the reporter.

The best way to have solid answers to each of the questions that could arise is to be certain that no decision is made lightly or without full information. Potential conflicts should be evaluated in advance, and if a decision is made to go ahead despite the possible conflicts, the risk should be made as small as possible through appropriate precautions and safeguards.

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Safeguards Against Conflicts of Interest

The best response to later questions is that all parties had a clear and accurate understanding of how the venture was to be structured, financed and operated. In order for this to occur, representatives of the university's business office, legal office, research administration, public affairs office and top administration must be involved in the decision-making process. Where potential conflicts are identified during a rigorous review by these offices, safeguards must be built into the arrangements between the institution and the spin-off venture.

Advance disclosure can protect the principals. Although it may be distasteful to disclose information which would be considered strictly private except for the spin-off arrangement, decisions made in the absence of this information will be vulnerable to second-guessing both in the press and in the court system, should it come to that.

Any investor who would refuse to invest in the spin-off as a result of disclosed information is not an appropriate partner in these kinds of ventures. In some cases, the investor's decision may be based on an astute business analysis; if that is the case, it is a good idea for both the university and the entrepreneur to take this reluctance seriously, and to try to understand it. If, on the other hand, the prospective investor is reacting negatively to the simple fact of disclosure, without reference to the content of the information disclosed, then that investor is better off steering clear of business relationships with public institutions, or with institutions whose research is publicly funded.

In some cases, entrepreneurs or investors resist disclosure because of concerns that proprietary information will be disseminated more broadly, with possible adverse effects on competitiveness. Much Freedom of Information legislation provides for the confidentiality of such information. In addition, administrative means are available within institutions to protect such information from detailed dissemination even within the walls of the university. It is possible

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for the institution to know what it needs to know to enter into a partnership by seeking outside expert counsel; this may circumvent the need for those negotiating the arrangement to have complete, detailed knowledge of business plans and proprietary information.

Disclosure of all outside financial interests already has become a matter of policy at many research universities. Others are in the process of developing detailed conflict-of-interest policies that are designed to protect both the institution and the individual from harm through advance disclosure of all possible conflicts. Such policies generally are not limited to spin-off situations, but cover all outside income-producing activities of faculty and staff.

These policies frequently ask faculty and staff members to disclose not only their own financial or managerial interest in spin-off businesses, but that of members of their immediate family. A decision made in the absence of this information will be subject to question and reconsideration. If this information looks sufficiently bad to the principals that they prefer to keep it secret, it will look even worse to the outside world.

Possible safeguards can include official guidelines for the use of the institution's facilities, equipment, name and resources. Such guidelines should address such issues as who has access to these assets, and how (if at all) they are expected to compensate the institution. In many cases special oversight procedures will be necessary to ensure that the decision-making process has been free of inappropriate influences, and that the institution's primary missions of teaching, research, and public service are not compromised. An on-going system for monitoring the relationship may be required.

Seeking Advice and Documenting Decisions

The consequences of entering into a partnership based upon incomplete or inaccurate information can be severe. The best way to avoid this situation is by inviting a diverse group of professional experts to examine the proposed arrangements from every possible angle. The areas to touch upon include legal, financial, public relations, technical and regulatory

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implications of the proposed use of university resources and facilities; university expenditures, and the university name. Expert advice should be sought in all these categories; most universities have such expertise in-house, but the use of outside experts also should be considered.

It is essential to remember that it is in the best interests not only of the institution but of the individual entrepreneur and the investors for all these precautions to be taken, and for all possible problems to be thought of and taken account of in advance. This process can be time-consuming and frustrating, but is easier and less costly than attempting to justify actions in retrospect without benefit of documentation.

Thus, the entrepreneur should be certain that the university documents all its decisions, including its rationale for making them in full awareness of the potential risks and benefits.

The entrepreneur and his or her advisers should examine the proposed agreement carefully with an eye toward identifying trouble spots. Whenever the arrangement calls for the use of public resources -- facilities, equipment, or time -- for the benefit of the private company, the entrepreneur should require that someone with no interest in the company is part of the approval process. The entrepreneur should not rely upon the university to protect his or her interests. While these are not conceived as adversarial negotiations, and the best contracts will not leave either side exposed, the primary concern of institutional attorneys and administrators will be to protect the institution. Therefore, it is incumbent upon the entrepreneur -- with the best professional advice -- to double-check the prospective arrangements for personal vulnerabilities.

Spin-off arrangements can be profitable and positive for all concerned, so long as the proper care is taken in laying the groundwork and following through. The inherent risks are part of any entrepreneurial venture. Neither institutions nor individuals should be deterred from taking a close look, balancing the risks against the possible benefits, and moving forward with all due care.