MOFO TECH

SPRING/SUMMER 2013

INFORMATION, TREND-SPOTTING, AND ANALYSIS FOR SCIENCE AND TECH-BASED COMPANIES FROM MORRISON & FOERSTER LLP

Washington's Wide Web

What the administration's agenda means for tech companies

DEALMAKING:
Why scientific acumen isn't enough

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Borrowing against royalties

SUSTAINABLE DESIGN:
The site-based approach

3-D PRINTING:
A new legal dimension

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INFORMATION, TREND-SPOTTING, AND ANALYSIS FOR SCIENCE AND TECH-BASED COMPANIES FROM MORRISON & FOERSTER LLP

SPRING/SUMMER 2013

Behind every trend are new complications. And, often, laws trying to flatten the wrinkles the trends have wrought. Look at social media, for example (page 2). Financial institutions and investors have flocked to Twitter to share their news. But the FBI and the SEC are listening in, ears tuned to evidence of insider trading. And then there's 3-D printing (page 3), primed to create everything from aircraft parts to smartphone cases. Like photocopying, videos, and music downloads before it, this new technology offers convenience—and lots of opportunities to infringe: on patents and copyrights, on rights-of-publicity, on market segments. This issue of *MoFo Tech* is focused on just those sorts of developments, and the ways in which both the inventors and the users of these technologies are grappling with the resulting complications—and not only solving them, but profiting as well.

[With less VC funding], there is a distinct need for capital resources.

—Nate Hukill, managing director, Capital Royalty, page 11

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THE 411

China Seeks Technology

Acquiring rights to U.S. and European technologies has become a priority for Chinese companies—as well as national policy. "Large state-owned companies possess phenomenal production capacity, but generally lag in R&D and technological advancement," says Morrison & Foerster Beijing-based partner Sherry Xiaowei Yin. "Acquiring technology assets allows them to diversify their products and ascend the global supply chain." Also in Beijing, Morrison & Foerster partner Thomas Man notes that "small to medium-sized U.S. companies in cleantech, IT, and biotech are attractive targets."

This fast-expanding deal cosmos has unique complexities, starting with U.S. government security concerns over sensitive technologies. Differing corporate governance, financial reporting, and accounting standards can be thorny, too—along with a transactional learning curve.

"As a group, Chinese acquirers are diverse players with individual constraints," says Hong Kong-based Morrison & Foerster partner Thomas Chou. "Not all are experienced in outbound M&A deals, or in navigating the U.S. regulatory framework."

Still, Chinese executives, returning with lessons learned in the U.S., are growing more sophisticated. "Securing IP assets is a priority," says Morrison & Foerster partner Janet Xiao. "Yet parties often overlook due diligence regarding freedom to operate, chain of title, and other IP concerns. These can become irreparable later on."—*J. H.*

[LOG IN] By Gary Stern

Stop Insider Tweeting!

Feds eye social media for securities shenanigans

As financial institutions and investors turn to social media to instantly share snippets of news and potential clues about market trends, the FBI and SEC are monitoring such postings for evidence of insider trading and improper investment information. Companies must comply with pre-Internet federal securities laws covering antifraud, advertising, record keeping, and more, even though the use of Facebook and Twitter is far outpacing the development of federal regulations aimed at social media.

Late last year, two FBI agents told Reuters that they see social media as a breeding ground for insider trading and securities fraud. "If there is any way to exploit it, these individuals will," one agent said. The FBI also began a public search for an application that would scan social media for national security threats. "In trying to establish whether a trader who made significant gains in advance of market-moving news got nonpublic information from a company insider, the FBI might be interested in a list of the trader's friends and contacts on social media sites," says J. Alexander Lawrence, a Morrison & Foerster partner who works in securities law. "Evidence on Facebook, LinkedIn, or other sites could help the FBI connect the dots."

Government investigators have been pursuing insider traders with growing intensity, according to Morrison & Foerster's 2012 *Insider Trading Annual Review*. One reason could be the relative lack of success in bringing cases related to the financial crisis. "While the SEC and DOJ have been criticized, fairly or

LANCE JACKSON FOR MOFO TECH

not, for not bringing more cases arising from the financial crisis—especially against individuals—both agencies have received abundant praise for their crackdown on insider trading," the report concluded.

When communicating information through social media channels, companies have had to carefully consider whether material nonpublic information is being selectively disclosed in violation of Regulation FD. The SEC recently clarified its views regarding the applicability of Regulation FD to social media in a Report of Investigation which concluded that disclosure of material nonpublic information on the personal social media site of an individual corporate officer, without advance notice to investors that the social media site may be used for this purpose, is unlikely to qualify as an acceptable method of disclosure under the securities laws.

However, the SEC indicated that companies using social media to communicate information could apply existing guidance on the use of corporate websites in determining if that information is adequately being disseminated through social media channels so that a company won't run afoul of Regulation FD, which would include taking steps to notify the market that material information about the company can be gleaned from those social media channels.

There are legal uncertainties about how far investigators can go in seeking information that is not publicly available on social media. Courts have ruled that certain messages sent on social media are protected under the Stored Communications Act, which limits the government's power to force Internet service providers to disclose customer information. In addition, "friending" someone for the sole purpose of uncovering evidence may go against Facebook's terms of service. States differ as to whether investigations led by attorneys can use deception, such as "friending" someone to uncover evidence, says Carl H. Loewenson Jr., a Morrison & Foerster partner and co-chair of the firm's Securities Litigation, Enforcement, and White-Collar Defense Group. "If a prosecutor directs agents to do that, there is the risk of ethical violations resulting from engaging in misrepresentation under some state bar rules," he says.

MATT HERING FOR MOFO TECH

[FOCUS] By Eric Schoeniger

3-D Printing: New Dimension for IP Law?

Just as inkjet printers deposit drops of ink to create a document, 3-D printers lay down bits of plastic, metal, or other material to build an object. But as 3-D printers enter the consumer market, they may also fashion new challenges for intellectual property law.

Commercial 3-D printers, which can cost $50,000, are already being used to manufacture parts for aircraft and other machinery. Now, $500 home printers are allowing consumers to download design files and print items as diverse as jewelry, smartphone cases, and kitchen gadgets. Meanwhile, retailers like Staples have plans to offer 3-D printing as a service.

"3-D printing is yet another manifestation of reproduction capabilities extending to the masses," points out Michael Jacobs, a Morrison & Foerster partner. "Xerox machines were first. Videos were another example; music downloads yet another. Each time, the IP law has come under stress, yet accommodations have been reached. That will happen with 3-D printing, as well."

Still, how those eventualities play out remains to be seen. For example, "there could be right-of-publicity issues affected by 3-D printing," says Craig Whitney, a senior litigation associate at Morrison & Foerster. "A bobble-head doll of your favorite athlete or actor could be yours at the click of a button, with no control by or compensation to the celebrity whose image is being misappropriated."

What's more, 3-D printing could alter market segments, Whitney suggests. "Makers of consumer electronics, for example—particularly hand-held devices—could see consumers sharing images of replacement parts or after-market products and printing them," he says. "That could supplant an entire market." Companies that create tangible, three-dimensional objects are no longer immune to the risks of file sharing that the music and film industries have dealt with for more than a decade.

Some IP holders will want to vigorously defend against patent or copyright infringement related to 3-D printing, while others may be wiser to embrace it—for example, by offering files that let consumers print their own copies of products or spare parts. "This technology is here, and it's only growing," Whitney says. "Rather than fight it, you might want to take advantage of it to monetize your copyrights."

[AGGREGATOR] By Peter Haapaniemi

Ahead of the LEED

Site-based sustainable design can speed official approval

The effort to create sustainable buildings has long centered on technical certifications, such as LEED. But now, some companies are taking more of a big-picture view. "They're looking at the entire corporate campus as a system to reduce the overall environmental impact, instead of trying to use detailed technical building specifications—this window glazing, or that insulation," says Zane Gresham, a partner at Morrison & Foerster. "So the focus is on the outcome you want, rather than on the detailed steps you take."

For example, Gilead Sciences is expanding its headquarters in Foster City, Calif., essentially doubling its footprint. "The company is looking not just at physical facilities and energy use, but also at such factors as transportation and water conservation," says Gresham, who works with Gilead on the project. As a result, Gilead has been able to show that the campus will have a significantly lower environmental impact than traditional development on the site. "Now, the city and Gilead are developing a flexible planning framework based on meeting key sustainability metrics, rather than prescribing the exact location, size, and use of future building on the campus," says Gresham.

This holistic approach received a limited legislative boost with the 2011 passage of California's Jobs and Economic Improvement Through Environmental Leadership Act, which streamlines environmental reviews for major construction projects that don't increase greenhouse gas emissions. Apple Inc.'s proposed new headquarters in Cupertino—to be built on an existing HP site—is the first and only project to be approved under the new law to date. To attain that approval, Apple determined the amount of greenhouse gas emissions the facility had generated and created an innovative design that incorporates everything from solar panels and electric vehicle charging stations to drought-resistant landscaping. "We were able to establish that there's no net increase in greenhouse gas emissions resulting from the new proposed project," says David Gold, a Morrison & Foerster partner who is working with Apple on the project.

Creating these broader plans can be complex, and local agencies, environmental groups, and public opinion all have a role to play. But these plans can also enable companies to grow their facilities while helping to ensure that they meet their long-term sustainability goals. "Instead of rigid rules," Gold says, "this holistic approach focuses on achieving desired levels of sustainability performance, with the flexibility to adapt to emerging technologies and changing market conditions."

Crowdfunding: Caveat Emptor?

How different are the markets for crowdfunding—an emergent online platform for raising small sums from multiple investors—in the U.S. and the U.K? "While Title III of the JOBS Act would establish an SEC exemption for crowdfunding, the SEC has yet to propose or adopt implementing rules," says Washington, D.C.-based Morrison & Foerster partner David Lynn. "Absent registration with the SEC, equity crowdfunding online is likely illegal, absent the availability of an existing exemption."

"There is an expectation that raising capital online will prove less costly and may provide more funding sources than traditional methods," adds Morrison & Foerster partner Lawrence Bard. "Yet burdensome reporting requirements may prove complicated and costly, making crowdfunding's viability largely dependent on the amount charged by intermediaries."

In a statement last August, the U.K.'s Financial Conduct Authority outlined the benefits and risks of crowdfunding and suggested ways in which investors can protect themselves. "Pro-crowdfunding bloggers interpreted the statement as a warning," says London-based Morrison & Foerster partner Chris Coulter. "Striking nerves especially was the FCA's stated concern over the exposure of unsophisticated investors to unregulated operators."

Because detailed diligence with crowdfunding is unrealistic, investors may be better off working with FCA-approved entities, which must provide more disclosure on investment offerings, says Morrison & Foerster partner Justin Stock, also in London.—J.H.

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[SUPPORT] By Jennifer Pilla Taylor

Call the Patent Police!

Time to monitor competitors' filings

More companies will likely begin closely monitoring their competitors' patent filings with the aim of opposing them under new procedures established by the America Invents Act, which went into full effect on March 16.

The sweeping patent reform legislation—under which the U.S. switches to a first-to-file from a first-to-invent system—also creates new tools for challenging newly granted patents. And monitoring programs will be key to many companies' strategies using those tools, says Morrison & Foerster partner Matt Kreeger.

Under post-grant review, for example, a patent granted under the new system can be challenged on a wide variety of grounds in front of the newly established Patent Trial and Appeal Board, which is staffed by administrative patent judges. Previously, oppositions could only be filed on very limited grounds, and rulings were issued by USPTO re-examiners.

A petition for post-grant review, however, has to be filed within nine months of the patent's issuance. Given that tight time frame, companies with programs in place to quickly identify patents they intend to challenge will have a strategic advantage.

Monitoring competitors' patent filings has been a more common practice in Europe, which has had AIA-like opposition procedures for many years, says Morrison & Foerster partner Richard Hung. Some companies have their own elaborate in-house monitoring programs, while others rely on patent monitoring services.

Kreeger says that while the new opposition procedures could be powerful competitive tools, they're not without risk. A poorly drafted post-grant review petition could result in a company's being barred from later asserting certain claims in federal court, for example.

And it will take some time to assess how well the PTAB forum works, Kreeger says. "This really could change the face of patent litigation," he notes. "The near future will be spent figuring out exactly what it will all look like."

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Cleantech: Holding Its Breath

Many had hoped that the start of quarterly auctions under California's new cap-and-trade program would usher in an era of rapid growth for the cleantech sector.

But a pair of lawsuits filed by business groups challenging the program's validity has cast a cloud of uncertainty over the program, says Morrison & Foerster partner William Sloan. The first two auctions—held in November and February—were important milestones for cleantech, Sloan says, because now there is a clear market price on carbon emissions. That gives entrepreneurs a more direct way to place a monetary value on their innovations for potential customers and investors.

A court decision in favor of the program could provide a real cleantech boost. Also on the sector's wish list: an expansion by state regulators of the types of carbon-reducing projects—also known as offset projects—that carbon emitters can invest in to help fulfill their compliance obligations. —J.P.T.

Get That Grant

The Small Business Administration has made it easier for small businesses that receive venture funding to participate in a $2-billion-a-year federal grant program to promote innovation.

The Small Business Innovation and Research program had been open only to companies that were majority-owned by individuals who were U.S. citizens or permanent resident aliens. That barred many small companies with significant outside investor ownership from participating, says Morrison & Foerster partner Bradley Wine.

Under the new rules that went into effect Jan. 28, the grant funding can now be accessed by companies that are majority-owned by multiple venture capital operating companies, hedge funds, or private equity firms.

[UPDATE] By Ken Stier

Food Labels: Watch for Scary Ingredients

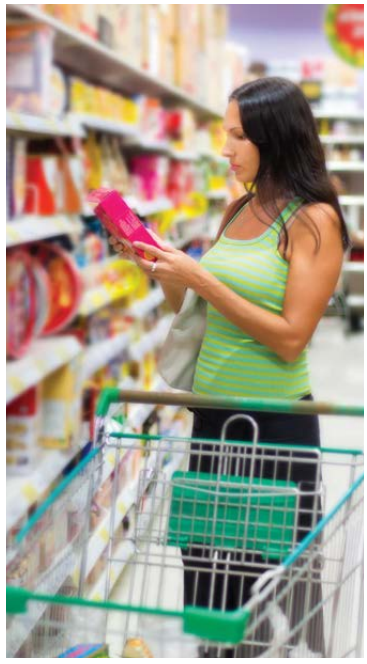
Consumers are eager to know more about the food they buy, and companies are eager to tell them. But the companies face a legal minefield, as plaintiffs' lawyers parse every word on every label for something they can claim is misleading.

More than 200 cases of so-called misbranding have been filed in California's Ninth Circuit since its 2008 ruling that factually correct disclosure on the FDA-mandated nutrition facts box isn't a defense against possibly misleading labeling. A year later, Dannon paid $35 million in a settlement over the claim it overstated its yogurt's ability to improve digestion. Untold numbers of cases have settled since. The threat of being class certified and of having to undergo "bone-crunching" electronic discovery has forced many companies to settle, says William Stern, a Morrison & Foerster partner in San Francisco.

Last November, voters rejected a proposition that would have required labeling of food products with any genetically modified ingredients. The measure might have taken a toll on California's huge but low-margin food industry, in part because the enforcement mechanisms are virtually the same as those of Proposition 65, the controversial law aimed at protecting consumers from harmful chemicals. The vast majority of claims under that law have settled because the price of defending a case on the merits is too high, observes Michèle Corash, a Morrison & Foerster partner and recognized authority on Proposition 65.

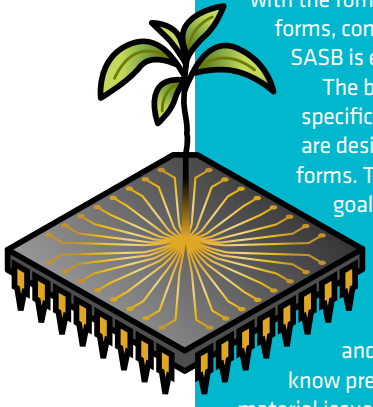
Even without new labeling laws on the books, expect more litigation. Certain words are especially likely to attract a litigant's attention. One is "natural"—"if you use that word, you'd better be sure you can defend every ingredient," says Stern, who consults on labeling. Ultimately, he says, legal exposure can be contained—but not eliminated.

"If you use that word [natural], you'd better be sure you can defend every ingredient," says Stern.



Accounting for Sustainability

A number of U.S. states have created new corporate forms that let companies focus on sustainability and other social goals, as well as shareholder value. [See "Risk & Responsibility," *MoFo Tech,* Spring/Summer 2012]. Now, we are seeing the "logical next step" in corporate sustainability, says Morrison & Foerster partner Susan Mac Cormac, with the formation in October 2012 of the Sustainability Accounting Standards Board. In those new corporate forms, companies are required to use best practices for reporting on social and environmental factors—and the SASB is establishing those best practices.



The board is determining what is material in terms of sustainability and disclosure and creating industry-specific standards for including sustainability information in Form 10-K and other filings. These standards are designed for use by all public companies, whether they are using the new or traditional corporate forms. The SASB plans to develop standards for 89 industries in two and a half years, with the ultimate goal of bringing clarity to sustainability reporting. "The simple innovation of providing the accounting infrastructure for comparable, industry-specific sustainability information within existing market systems makes SASB a game-changer," says Jean Rogers, executive director of the SASB.

Clear standards will help companies on several fronts, says Mac Cormac, who sits on the SASB board of directors. Many companies are already reporting sustainability information in separate and often voluminous statements. "Standards can streamline those efforts by letting companies know precisely what to report, and help them improve compliance with SEC rules about disclosing material issues," she says. Standards will also let them know what not to report, reducing costs and the risk of unnecessarily reporting information that might have a negative effect on shareholder value. Moreover, Mac Cormac adds, companies can use standards to enhance their long-term competitiveness. "Standards can help companies better understand their sustainability challenges and focus on addressing the things that have a material impact on the business." *–P.H.*

SHUTTERSTOCK

HERE COME THE FEDS

What President Obama's second term means for the tech industry

As the first president to appoint a chief technology officer, President Obama has worked hard to portray himself as a friend to the tech industry. He's supported the expansion of broadband access, development of a fourth-generation wireless network, new healthcare IT initiatives, and a modernized electrical grid. In April, he called for reversing recent spending cuts to several federal government R&D budgets and boosting 2014 civilian R&D spending by 9 percent over 2012. (Defense R&D would decline by 6 percent.) It is far from certain his budget will make it through a divided Congress, however.

The tech industry has been paying a lot of attention to Washington. Legislators and regulators have woken up to the increasing influence of high technology on ordinary citizens' lives. And for better or worse, they have become increasingly interested in shaping that influence. At the same time, tech executives have learned how a vote or ruling can mean the difference between a profit and a loss.

As President Obama's second term takes shape, here's a rundown of some areas of federal policy that tech industry representatives in Washington will be talking about. Like it or not, the outcome of these discussions could have a big influence on your company's marketing, hiring, finances, and more.

By Richard Sine • Illustrations by Kurt Ketchum

Federal lobbying by the tech industry rose 140%

CYBERSECURITY: FRAMEWORK AHEAD

Last October Defense Secretary Leon Panetta warned that the United States faced the possibility of a "cyber-Pearl Harbor," raising the specter of an aggressor nation or extremist group derailing trains, contaminating water supplies, or crippling power grids. Also last year, Gen. Keith Alexander, chief of the U.S. Cyber Command, claimed that intrusions against computers that run essential infrastructure increased seventeen-fold from 2009 to 2011. He has called the loss of intellectual property and industrial secrets from cybercrime "the greatest transfer of wealth in history."

Panetta urged Congress to take action, but efforts to pass cybersecurity legislation last year were sunk in partisan discord. A bill co-sponsored by Independent Sen. Joseph Lieberman and Republican Sen. Susan Collins would have required minimum cybersecurity standards on computer systems controlling critical infrastructure. The bill was redrafted to make those standards voluntary in an effort to garner votes, but the bill was blocked via filibuster by Republicans led by Sen. John McCain.

In February, President Obama issued an executive order that promotes information sharing about cyber-threats between the government and private companies. The order directs federal agencies to provide timely notification to companies that operate critical infrastructure of any cyber threats that identify the company, and it expedites the processing of clearances for company personnel to enable the government to share classified threat information. Meanwhile, the National Institute of Standards and Technology will develop a framework to reduce cyber risks and "work with industry to identify existing voluntary consensus standards and industry best practices to incorporate into the framework," in the words of the president's cybersecurity coordinator, Michael Daniel. Adoption of those best practices and standards will be voluntary.

"All indications are that the work on this framework will be a fairly open process," says Nathan Taylor, Of Counsel at Morrison & Foerster in Washington D.C. "The tech sector will have the ability to comment on and impact what those best practices should be and what the ultimate standards are."

It's an open question, however, exactly how computer systems and networks will be defined as "critical infrastructure" by the federal government, and therefore which companies will be affected by the order, says Taylor, a privacy and information security specialist who has worked with financial services clients on their lobbying efforts related to cybersecurity matters. The order defines critical infrastructure as being so vital that its destruction "would have a debilitating impact on security, national economic security, national public health or safety." A recent Presidential Policy Directive

The FCC Defends an "Open Internet"

Much of the glamour of technology today rests on the amazing things one can do on the Internet. The Federal Communications Commission plays a big role in deciding how affordable and accessible those wonders will be for Americans.

Case in point: Internet service providers are imposing usage caps and pricing tiers based on the amount of data their customers use. They say these measures help ease network congestion and fund additional investment in infrastructure.

But these measures promise to crush the business models of streaming-media companies like Netflix and Hulu, which claim the measures only serve to stifle innovation and bilk customers. These companies claim that some of these ISPs—some of which also operate cable systems or cellular networks—favor their own content over those of Internet-based competitors.

This year could be a significant one for Internet access issues. A ruling is expected in a case in which the Federal Communications Commission is defending its "open Internet rules" before the U.S. Court of Appeals in Washington, D.C. The FCC argues that the rules have been a boon for investment in both Internet companies and wired and wireless infrastructure.

Some speculate that the FCC will lose, because the D.C. court previously ruled that the FCC lacked authority to stop Comcast Corp. from blocking bandwidth-hogging applications on its broadband network.

Meanwhile, Democratic Sen. Ron Wyden of Oregon introduced legislation last year that would require the FCC to intervene so that data caps were intended only to relieve network congestion. And in February the FCC proposed increasing by over one-third the amount of spectrum available to unlicensed wireless devices. The measure is designed to relieve congestion on public Wi-Fi networks and encourage innovation in wireless devices. Previous unlicensed spectrum has made possible innovations such as cordless phones and garage door openers, *The New York Times* notes.

from 2000 to 2012 —Center for Responsive Politics

describes 16 "critical infrastructure sectors," including information technology, financial services, communications, and energy. But the order specifies that the Department of Homeland Security cannot include "any commercial information technology products or consumer information technology services" in its inventory of "critical infrastructure at greatest risk."

That clause suggests that tech companies have succeeded in lobbying the Obama administration to limit the order's impact, Taylor says. Indeed, while some tech companies have favored stronger federal action—and companies that provide data security solutions stand to benefit from federal mandates—others have feared that regulation could create an expensive and ultimately ineffective burden. Data security technologies—and the nature of cyber threats—are evolving so rapidly that there is a risk that any mandated technology or strategy could become outdated before the regulation's ink is dry, Taylor says. It could even thwart cyber-defense innovation, as companies focus on complying with regulations rather than responding to threats.

PRIVACY: PUSHING THE BALL FORWARD

The preservation of consumer privacy in the face of web browser cookies, GPS tracking, and Big Data remains a hot topic in the media. A split Congress means that a comprehensive data privacy bill is unlikely, says Reed Freeman, a Morrison & Foerster partner focused on consumer protection. But Obama's re-election suggests that he and his party will continue to encourage (or oversee) industry efforts to self-police—and will push targeted legislation if those standards fail to make an impact.

For example, the Department of Commerce's National Telecommunications and Information Administration is attempting to develop a code of conduct around consumer privacy involving companies, academics, and privacy advocates. (Adoption of the code would be voluntary, but companies like Facebook and Google that have failed to live up to their stated privacy policies have faced disciplinary action from the Federal Trade Commission.) The administration's group has met for nearly a year and is still working on its first issue, involving the mobile environment. "The administration is likely to try to speed up the process," Freeman says. The dialogue is still important to track for companies that advertise or deliver advertising on the Internet.

Under Democratic control, the Federal Trade Commission has expanded its interests beyond fraud and misuse of data to more intangible harms that could be caused by data use, like an "affront to dignity." "They're looking into issues that could result in fairly dramatic policy changes," such as data brokering, Freeman says.

A group formed by the Worldwide Web Consortium, or W3C, has been working for over a year with companies, advocates, trade associations, and officials to develop standards around "do not track." If that effort stalls, the chair of the Senate Commerce committee, Senator Jay Rockefeller, may push through "do not track" legislation that would give the FTC the right to define and regulate data tracking.

Tech companies that have been hit by onerous official requests for personal data as part of criminal investigations have united to push for reform of the 1986

Electronic Communications Privacy Act. That reform has a good chance of becoming law, Freeman says.

TAXES: GOOD NEWS, BAD NEWS

As much as tech executives like to focus on their product and their customers, taxes have a big impact on the bottom line. The tax legislation that averted the fiscal cliff on Jan. 1 included some good news for tech firms, notes Michelle Jewett, a senior tax associate at Morrison & Foerster. This includes the extension of a provision that allows businesses to immediately deduct 50 percent of the adjusted cost basis for many types of property. Taxpayers may also continue excluding 100 percent of the capital gains from sales of so-called Qualified Small Business Stock acquired in 2012 and 2013. The exclusion is a valuable incentive for the purchase of stock from tech and biotech start-ups, Jewett says.

There were also some pleasant surprises for companies focused on renewable energy and energy efficiency, says Robert Cudd, a Morrison & Foerster partner with more than 30 years of tax experience. These include extensions of some important production tax credits and investment tax credits. But many of these programs have their limits in terms of which investors and producers can qualify. And they come during a challenging period for cleantech companies. Most notably, the Department of Energy's Section 1705 loan guarantee program that expired in the fall of 2011 has not been replaced by anything of comparable size, and the highly effective Section 1603 cash grant program for renewable projects was not extended to apply to projects that begin construction after 2012.

The debate over the "fiscal cliff" brought the long-discussed need for comprehensive corporate tax reform to the front burner. Both Republicans and the administration have opened the door to an overall reduction in the corporate tax rate—the highest in the developed world—and the elimination of a range of deductions. Tech companies will keep a close eye on the deduction relating to the amortization of goodwill, Jewett says. That's because much of the value of many tech companies is derived from intangible assets such as patents and licenses, known in accounting parlance as goodwill.

It's unknown what form comprehensive tax reform might take. There has been significant attention paid to structures used by U.S.-based multinational corporations to avoid subjecting income earned by foreign affiliates offshore to U.S. taxes. But smaller efforts to boost tax revenue collection might also make a big impact. The Department of Justice may start more aggressively pursuing companies it believes are abusing foreign tax credits, Cudd says. And the tax holiday for Internet purchases may soon be over. As *MoFo Tech* went to press, a bipartisan bill, the Marketplace Fairness Act, that would allow states to collect unpaid online sales taxes, had passed the Senate and was under consideration by the House.

TECH WORKER IMMIGRATION: EASING A LABOR SHORTAGE

Tech industry leaders have long complained about the challenges of finding highly skilled engineers and programmers in the United States. The New Year saw the potential for a breakthrough on this front when Democrats and Republicans came together to call for comprehensive immigration reform. While most of the news about the President and Senate's proposals has been around border security and a path to citizenship for illegal immigrants, the Senate has also introduced a proposal to greatly expand the three-year visa program for highly skilled foreign workers known as H-1B. With bipartisan sponsorship, the Immigration Innovation Act would lift the annual quota of these visas from 65,000 to 115,000. The cap would grow each year if demand outstrips supply, potentially up to 300,000 visas.

The H-1B program promotes economic growth in the United States, not only in the tech sector but everywhere in the country, contends Chris Ford, chair of Morrison & Foerster's Global Sourcing Group. That's because the alternative to having IT work done in the U.S. by H-1B workers is often having it done overseas. And if the work is done here, then at least some of the money earned gets spent here and is taxed by the U.S. government.

Over the last two decades, many American companies have shrunk their in-house IT departments, keeping core personnel and outsourcing the rest. While many of these companies would like to bring in skilled personnel for onsite projects, they're stymied by the limitations in the current H-1B program, Ford says. This project-based labor shortage is especially acute for non-tech companies outside the major tech hubs. Ford gives the example of a Southeastern client in the transportation industry that sought onsite help with IT projects. But because it couldn't get the visas, the projects are on the back burner, which is potentially hindering its ability to implement necessary improvements. Such hindrances, across all affected companies, can have a negative impact on the nation's productivity.

The domestic labor shortage won't end, Ford says, until the U.S. trains more people in the so-called STEM skills: science, technology, engineering, and mathematics. One indication of the education gap: 95 percent of American high schools do not offer advanced-placement computer-science courses, notes the *Seattle Times*. To that end, the Senate bill would charge employers who apply for H-1B an extra $1,000 for each visa and use the money to bolster STEM education for American students.

As a Democratic administration, the Obama administration and its congressional allies appear to have a hands-on approach to problem-solving. They're happy to work with the tech industry to formulate voluntary solutions—and willing to impose mandates if those solutions don't suit them.

Royal Flush

Two Boulder financiers vow to make an impact in the life sciences field

Nate Hukill and Luke Düster first met in Shanghai, when the city was a boomtown with a skyline that was a forest of cranes. As college students studying abroad, they shared a small room, a tight budget—and a mischievous streak. So one day they snuck into a nearby luxury hotel to relax in its hot tub. There they met a Japanese businessman who regaled them with stories of the deals that moved those cranes. At the time, Hukill was studying language and Düster international affairs, but that night in 1995 they both made a fateful decision to switch to finance. "We decided we needed to get into the world and make an impact," Düster says.

Since then, Hukill and Düster have etched out a career finding alternative financing solutions in the life sciences arena. It's a field where long development times and risky product bets can make it difficult to structure deals that both the investor and the company find advantageous. In fact, for early-stage biopharma companies, obtaining financing from traditional banks is expensive or impossible. And raising venture capital often comes at a big price—a piece of the company — when it is available at all. "There is a distinct need for capital resources given the shrinking universe of VC funds, and we've found some success by offering non-dilutive credit-oriented strategies," Hukill says.

A former professional cyclist, Hukill became a pioneer in a financial product known as a royalty bond. In a typical royalty arrangement, an early-stage company that has developed a drug or medical device receives royalty payments from a large pharma firm in exchange for the right to commercialize the product. As recently as a decade ago, the primary way for these early-stage companies to raise capital was to sell the rights to their future payments outright. With royalty bonds, companies can borrow against those future streams instead. Once the bond is repaid, the borrower retains ownership of the residual royalty streams.

Beginning in 2005, Hukill spearheaded Highland

DON CUDNEY FOR MOFO TECH

The competitive spirit in Boulder runs from the office to the mountains and back again. Düster (left) and Hukill, a former professional cyclist, often race each other through the city's streets and trails.

"We decided we needed to get into the world and make an impact."

LUKE DÜSTER
PRINCIPAL

Capital Management's entry into biopharma royalties, helping Highland become the largest buyer of biopharma royalty bonds in the U.S. In 2009, he was lured by well-known Houston private equity investor Charles Tate to join Capital Royalty, which specializes in alternative biopharma financing. Tasked with opening CR's new office in Boulder, Colo., he called up his old friend Düster, then an investment banker in Richmond, Va.

With interest rates near rock-bottom, royalty bonds are appealing to private equity investors who are hungry for yield. In fact, non-traditional asset-backed securities are doing very well across the board as investors bounce back from the financial crisis, Reuters recently reported. About 7.5 percent of non-mortgage asset-backed securities issued in 2012 were backed by nontraditional cash flows, up from 5.3 percent in 2010, according to a Reuters research unit.

Royalty bonds first captured public attention in the late 1990s when rock musician David Bowie issued bonds tied to royalties from his music catalog. Recent bonds have been issued backing the Miramax film library, timeshare properties, and more.

In the case of life sciences-based royalty bonds, Capital Royalty helps control investor risk by focusing on products that are already FDA-approved. It also conducts intensive research. "One thing that distinguishes CR is the level of diligence they do on the companies they are lending to," says Morrison & Foerster attorney Bill Veatch, who has significant experience with monetization of royalty streams and works closely with CR. "They talk to the doctors and the nurse practitioners, the people who actually use the medical device or product, and figure out if the technology is performing well and is worth investing in."

CR recently closed its sixth investment in its most recent fund and is looking to deploy about $1 billion in capital over the next several years. Veatch has assisted with five transactions and is working on new investments as well. A typical example is TriVascular, a medical device company that markets a stent that allows repair of an aortic aneurysm without the need for open-heart surgery.

The new frontier for CR is structured debt, which has become the most popular form of capital for high-growth companies in the healthcare arena, Düster says. According to Veatch, the simplest form of structured debt is a loan in which the life sciences company's patents and related cash flows act as collateral. More complicated is a structured deal in which the funds go to a created subsidiary rather than to the borrower directly. This special-purpose entity receives the patents, the license, and the cash flow, Veatch says. If the borrower were to enter bankruptcy, the subsidiary is protected and the lender has a first claim to the IP as collateral.

"With structured debt we have rights to all the company's assets, but we give the company a two- to four-year period where they pay the interest only," Düster says. "Companies that are launching new products or investing in new product development can use the capital to fund their growth initiatives, as opposed to financing debt repayments."

For Hukill and Düster, honoring the commitment they made in Shanghai means helping CR grow and remain innovative. "We want to build something that matters," Hukill says. "I can't tell you it's the next Blackstone or KKR because we'll be unique. But it's a firm that will likely be a household name in 10 years." ■

CREDIT STRATEGIES: WHAT'S THE RISK?

All ways of raising capital entail risk. But for life sciences companies, employing credit strategies may be less risky than the alternatives.

Turning to venture capital typically requires giving up a slice of the company and a big portion of projected revenues. Raising capital through issuing shares often prompts shareholders to sell. By contrast, credit-based strategies such as royalty monetization and structured debt preserve shareholder value and owner control.

But loans must be repaid—and repaid on time. "These strategies work best when there is a pathway to generate enough revenue to eventually hit profitability and service their debt," says Luke Düster, principal at Capital Royalty, which offers credit to life sciences companies.

A whole host of issues can impact revenue streams, including competitive pressures, problems with reimbursement, and manufacturing challenges. Companies that do have trouble with debt repayments sometimes resort to raising additional equity. But CR typically structures its deals so that the debt is manageable even if revenues are 50 percent below forecast, Düster says. (Equity investors typically have much higher performance expectations.) Futhermore, many of CR's partners plan to be sold or make public offerings within five years, at which time the debt is fully repaid. "We give enough leeway through our long-duration [terms] and our interest-only period to get to that exit point," Düster notes. ■

DON CUDNEY FOR MOFO TECH

[DATAGRAM] By Jeff Heilman Charts by Alex Reardon

Biotech: Let's Make a Deal

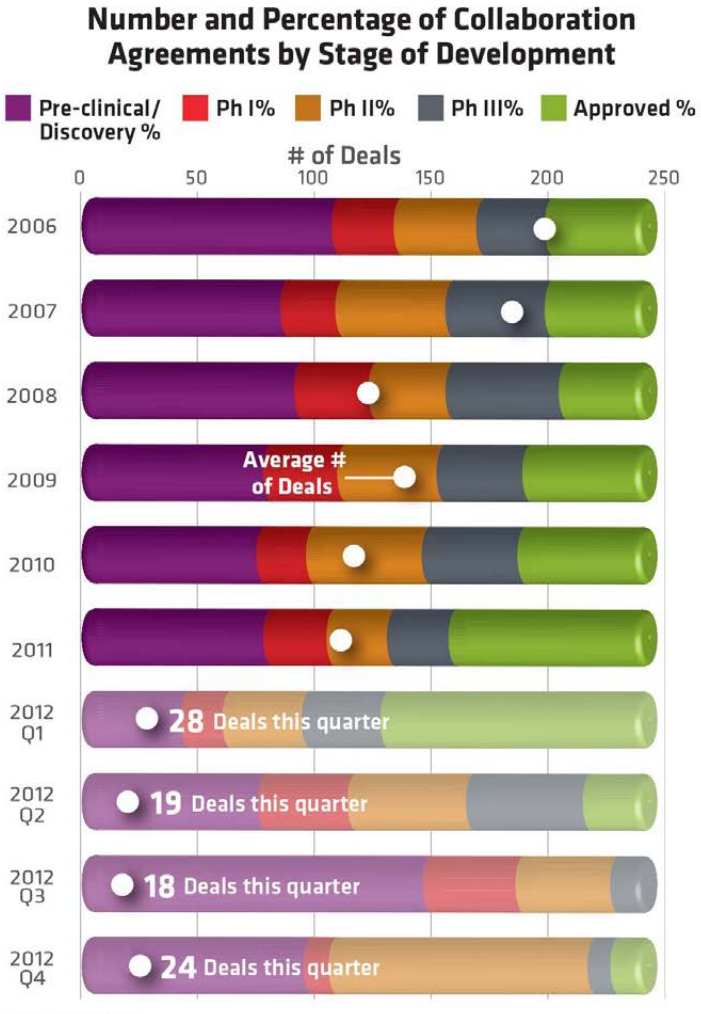
Scientific acumen is crucial—but so is an understanding of today's deal market.

The risks and costs of life sciences product development have become so high that few companies are willing to bear them on their own. As partnerships become vital, skill in dealmaking has become almost as vital as scientific acumen for today's pharma and biotech firms. Insight into the deal market is crucial for companies seeking to design advantageous deals.

That's why Morrison & Foerster has launched a quarterly deal report that answers key questions such as: what kinds of therapies are being bought at what development stages, and for how much. The report—dubbed MoFo BioMeter—is also a useful indicator of

Deal Slowdown

The absolute number of deals declined significantly from 2006 to 2012. Also, from 2006 to early 2012, the proportion of transactions for products with regulatory approval generally increased, demonstrating a willingness on the part of buyers to wait for the removal of regulatory risk. But the trend may be reversing, as Q2, Q3, and Q4 in 2012 showed a marked decline in approved product deals and an increase in the percentage of deals involving therapies in pre-clinical stages.



Source: MoFo BioMeter

Costs Rise, Belts Tighten

The cost of bringing a new therapy to market is 24 times higher than it was in 1979, according to Boston-based Tufts Center for the Study of Drug Development. Annual revenue of $1 billion is required to recoup R&D and marketing costs. "[I]n a world shaped by increased patent expirations, diminished cash flow, and fewer promising breakthrough products, companies will need to hone their efforts to streamline development," says Tufts CSDD Director Kenneth Kaitin.

the health of the biotechnology industry.

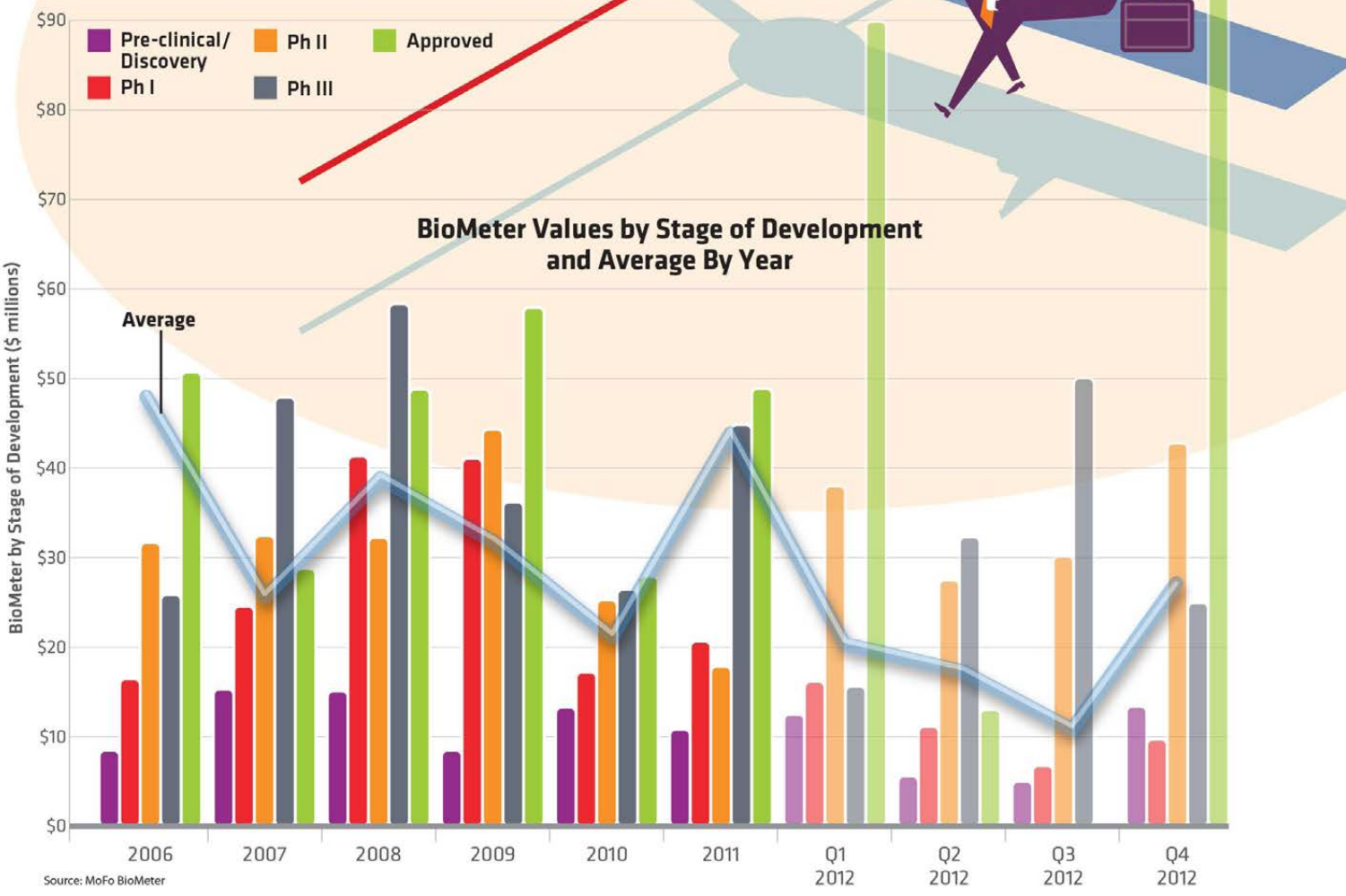
"In a time of constrained venture funding for unapproved life sciences products, up-front payments for promising assets still in development are a vital source of growth capital for young firms," says partner Stephen Thau, who created the BioMeter. "Meanwhile, leading pharmaceutical companies such as Pfizer have increasingly focused on their global sales and marketing capabilities over the last decade. In that time, their partnerships with biotech start-ups have become the lifeblood of the industry."

The BioMeter is an index that measures transactional data relating to collaboration agreements between large commercial firms and small developers, and can include licensing, joint ventures, acquisitions, and other deals for development-stage assets.

As biotech firms take their wares to market, BioMeter serves as an objective guide for evaluating the potential of assets across individual sectors, categories, and development stages. "If your interest is in testing assumptions about a given therapeutic, identifying pipeline opportunities, managing R&D budget allocation or assessing risk, BioMeter can guide informed decisionmaking," says Thau.

Prescription for Success

For venture firms looking to invest in emerging biotech companies, BioMeter can help indicate the right moment to step in. "Financial sponsors look for strategic inflection points in the product development cycle, such as self-sustaining cash flow or licensing deals with large firms," says Erik Knudsen, Of Counsel in Morrison & Foerster's private equity buyouts and investment group. "Tracking the commercial potential of development-stage assets, BioMeter allows investors to fine-tune their timing."



By Eric Schoeniger

Stop the Revolt

Retailers can use customer data without sparking privacy concerns

Seventy percent of Americans participate in at least one customer-loyalty program, according to a July 2012 survey by Polaris Marketing Research. Most of those shoppers are happy to give up personal information in exchange for discounts and special offers. But as retailers grab more data, will customers revolt? That depends on how retailers approach data collection and privacy, suggests Andrew Smith, a partner at Morrison & Foerster who concentrates his practice on retail financial services, privacy, and related issues.

Retailers capture data such as items purchased, items purchased in tandem, and amount and frequency of purchase. If they can associate that information with a particular customer through, say, a frequent-buyer program, they can build a customer profile. If they can link a credit-card number with a ZIP code, they can associate demographic information such as property value or income. If they have an email address, they can use a technique called "reverse append" to purchase a mailing address. And so on.

There are laws protecting specific kinds of information, such as personal data about children, health, or finances. "But in terms of general protection for general commercial data, there is not a single omnibus federal privacy law," Smith says. Instead, the U.S. takes a "sectoral" approach to privacy, backstopped by the FTC's ability to prosecute unfair or deceptive trade practices.

Some state laws address the collection of consumer data, notes David McDowell, a Morrison & Foerster partner and former co-chair of the firm's Consumer Litigation and Class Action practice group. For example, California prohibits businesses from requesting personal information such as a ZIP code during a credit-card transaction and requires businesses to disclose when they share customer information for marketing purposes.

As retailers capture more data and get better at analyzing and applying it, customers are receiving more finely targeted promotions—to the point they might feel their privacy is invaded. That should give companies pause. "Because some of this information is individual, there are individual views about what's private and what isn't," says Andy Serwin, a partner in Morrison & Foerster's Global Privacy and Data Security practice group. "So you can't simply say that collecting a certain type of information is always good or always bad."

When collecting and using customer data, businesses will always want to be within the law. "But in this context, collecting and using consumer data is often just a way to do more targeted marketing," Serwin notes. "You have to consider the type of information you're collecting, which customer segments you're collecting it from, and what you're providing in return. If your target market doesn't like what you're doing, they won't respond in the way you hope they will."

ROBERT PIZZO FOR MOFO TECH

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