

Designing a CRC for Long-Term Success

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PLEASE NOTE: This paper was prepared in 2000, but remains relevant to the 7th round and CRC planning generally.

With the sixth selection round of the Cooperative Research Centre Program in full swing, in which half of the existing CRCs have made application for further term of funding, it is an appropriate time for participants, or potential participants in CRCs to consider the long-term implications of the agreements under which CRCs operate. In this Article, Peter Francis, partner in commercial and technology law firm, Francis Abourizk Lightowlers, examines the issues to be considered in establishing a CRC.

When setting up the legal structure of a CRC, it is important to plan ahead for the stage when intellectual property created by research activities is to be commercialised. If changes to structure are made after the establishment of the Centre there may be significant taxation and stamp duty penalties. Of course, in the situation where all of the members of the Centre are tax exempt, liability for taxation is not an issue. In many instances, stamp duty exemption may also apply.

However, in many if not most CRC's there is at least one tax-payer who is a core participant and taxation can become an issue. As a general rule, whenever there is a change of ownership there is potential liability for taxation or stamp duty. Accordingly, if at some later stage, there is a need to restructure a CRC and this involves a change of ownership of Centre Intellectual Property and other assets, then a tax liability can be created.

Operational structure versus commercialisation structure

There may be different requirements for a Centre's operational structure on one hand and its commercialisation structure on the other. An unincorporated structure may prove a workable and flexible arrangement for the carrying out of the activities of the Centre - indeed, many of the Centres are unincorporated. However, an unincorporated structure has a number of serious limitations as a commercialisation vehicle. The choice of commercialisation structure needs to be closely related to the manner in which the parties have determined that Centre Intellectual Property is to be owned. There are a number of ways Centre Intellectual Property may be owned. These include ownership by:

- The participants as tenants-in-common in accordance with their equity in the Centre;
- The Centre itself;
- A special purpose company on trust for the participants;

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Issues which need to be taken into account when choosing an IP ownership structure include: control; risk management; attraction of new investors; taxation; administration; flexibility; implementation; commercialisation strategy; taxation status of participants; the nature of Centre Intellectual Property; and the most likely methods of its commercialisation.

The most important of these factors is the proposed commercialisation strategy, that is, how the Centre Intellectual Property is to be commercialised and what the commercial objectives are. For example, a commercialisation strategy could be limited simply to licensing the technology to a single entity which is one of the participants or indeed a non-participant. Alternatively, a separate commercial entity could be established which would have as its primary objective the commercialisation of the technology concerned. In the later case, the technology would need to be transferred out of the Centre by way either of assignment or of licensing. That would involve a transfer of rights or ownership which could have taxation consequences. It is important, therefore, to determine from the outset a structure for the ownership of the Centre Intellectual Property which will preserve as far as possible the rights of the tax exempt participants to receive their commercialisation revenues tax free. This may indicate that a trust be established at the time of formation of the Centre rather than a company. In that way, revenues are received by way of trust distributions which are not taxable in the hands of a trustee company rather than dividends which are paid out of profits and which must first be taxed in the hands of the company prior to distribution. At the time of writing, however, reforms announced by the Government may, if implemented, affect this aspect of the operation of trust companies.

Ownership Provisions in the Centre Agreement

Centre agreements often provide both general and specific directions in relation to the commercialisation of Centre Intellectual Property. As far as general directions are concerned, the Centre Agreement may provide that commercialisation of Centre Intellectual Property is to be carried out by an agent which may be an independent person or may be a member of the Centre. Further, the Centre Agreement may dictate that the commercialisation of Centre intellectual property is to be carried out in accordance with policies established by the board for that purpose. In all of this, the requirements of the Commonwealth Agreement must be kept in mind. The Commonwealth Agreement requires that Centre Intellectual Property must be commercialised for the benefit of Australia and that there shall be no disposal or rights granted in relation to the commercialisation of Centre Intellectual Property without the consent of the Commonwealth, which is not to be unreasonably withheld. As to specific directions in the Centre Agreement in relation to the commercialisation of Centre Intellectual Property, these may include:

- The granting of options to participants to commercialise Centre Intellectual Property against specific applications;
- The appointment of one or more participants to commercialise Centre Intellectual Property; and/or

- The establishment of a different class of the outcomes of the Centre, sometimes called project intellectual property, other times called Participant Intellectual Property, which is owned by a sub-set of the members of the Centre. In this situation, a specific member or members of the Centre may be given ownership and commercialisation rights in relation to certain technologies, which they are to exploit on terms subsequently to be determined. Revenues arising from that activity are to be divided in accordance with a preset formula.

Advantages and Disadvantages of Various Structures

Joint Ownership

In this arrangement, Centre Intellectual Property is jointly owned by the participants as tenants-in-common in accordance with their respective equity in the Centre. This is typically the scenario that prevails in unincorporated Centres. It involves the legal and beneficial ownership of the Centre Intellectual Property being divided among the participants proportionally. Each participant has an ownership interest in the Centre Intellectual Property that is commensurate with its equity in the Centre. A participant's contribution to the Centre bears to the total contributions made by all the participants to the Centre.

Advantages of Joint Ownership: Control, i.e. all owners must agree on commercialisation; recognition; and preservation of Section 73B R&D deductions.

Disadvantages of Joint Ownership: Joint and several liability; administrative difficulties; inefficiency; potential tax liabilities when moving to an incorporated structure; and impediment to attracting new investors.

Corporate Ownership

In this situation, an incorporated Centre owns the legal and beneficial interest in the Centre Intellectual Property. Because of its taxation limitations, this structure is fairly unusual and will only be effective where all of the participants are non-tax payers.

The taxation limitation flows from the fact that, if Centre Intellectual Property is legally and beneficially owned by the incorporated Centre, research expenditure by tax paying participants, in the absence of their securing some other rights to the Centre Intellectual Property, would not be tax deductible either under general principles or under Section 73B of the Tax Act.

Advantages of Corporate Ownership: Limited liability; administrative efficiency; attraction to new investors.

Disadvantages of Corporate Ownership: Possible loss of s 73B R&D deduction control; decisions on commercialisation made by majority decision; and 'locking-in' of technology.

Owned by the Centre on Trust for the Participants

In this situation the Centre, an incorporated entity, usually a company limited by guarantee, owns Centre Intellectual Property on trust for the participants in accordance with their equity in the Centre. Its advantages and disadvantages are similar, if not

identical, to ownership by a special purpose company which holds the Centre Intellectual Property on trust for the participants in accordance with their equity in the Centre (discussed below).

Special Purpose Company

In this situation, a special purpose proprietary limited company is established with nominal capital and charged with the task of holding Centre Intellectual Property on trust for the participants in accordance with their equity in the Centre.

The shareholders in the company are usually the participants in the Centre and its board is usually a sub-set of the board of the Centre.

The company, which I will call TrustCo, then enters into a simple agreement with the members of the Centre under which the rules of the trust are established. The terms of the trust agreement may include that TrustCo will:

- Hold each item of Centre Intellectual Property as trustee for all of the participants in accordance with their equity in the Centre;
- Acknowledge and agree that its role is merely to hold the Centre Intellectual Property as trustee to facilitate commercialisation of the Centre Intellectual Property and not to otherwise to affect the rights and obligations of the participants under the Centre Agreement; and
- Comply with all directions given to it by the board of the Centre.

Advantages a Special Purpose, Trustee Company: limited liability; preservation of Section 73B entitlements; flexibility; administrative efficiency, less regulation than a corporate or partnership structure; no joint and several liability; legal capacity; and control.

Disadvantages of the Special Purpose Company: complexity; and cost of establishment and maintenance.

Making the Decision

Whilst taxation and other costs are relevant to the choice of an appropriate structure for the commercialisation of Centre Intellectual Property the most determining factors are commercial ones and they, in turn, depend on: the nature of the Centre; the nature of the Centre Intellectual Property likely to come out of the Centre; the commercialisation strategy to be adopted; and the extent to which third parties will be required to contribute capital and other resources to the commercialisation of Centre Intellectual Property.

Whilst in the abstract it is inappropriate to recommend any particular structure, it is possible to say that, because of its flexibility and other advantages, an unincorporated Centre combined with the simple trust structure or a variation of it should always be considered and in many instances will be found appropriate.

If you would like to discuss the contents of this article please contact Peter Francis at Francis Abourizk Lightowlers, Commercial and Technology Lawyers.

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