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Letter from the Editors

Dear Readers,

Happy spring! This issue includes two articles that challenge conventional thinking. The first, called "Software is Still Patent Eligible," makes the case that software patents can still be obtained. IP generally accretes in value over time and is critically important to the value proposition of many enterprises. While some commentators believe that software patents are no longer worth trying to obtain, we disagree. The second article is about a novel way to construct a more balanced approach to the share ownership of founders and investors. People often forget that the NVCA (National Venture Capital Association) forms are created by counsel to the venture capital industry and as such are generally biased in favor of the investor. Our article proposes a novel solution to mitigate this bias and the solution is both simple and equitable.

Additionally, we highlight an exciting young company called BetterPT. BetterPT is revolutionizing the physical therapy industry with an easy to use app that connects patients, doctors, and physical therapists in a seamless fashion. It will modernize the physical therapy sector and enable patients to obtain faster and better care and includes an in-home concierge service.

As always, we welcome your questions and inquiries and we invite all of you to visit our website for emerging companies @ www.mintzedge.com

Sincerely yours,

Dan + Sam

Software Is Still Patent Eligible

BY MIKE VAN LOY, MIKE RENAUD, SANDRA BADIN, MATT KARAMBELAS, AND NICK MOUTON

In recent years, software patents have come under fire from legislation (the American Invents Act) that has generally made patents easier to invalidate, and from court decisions (the Supreme Court's decision in *Alice v. CLS Bank*[1] and its progeny) that have made computer-implemented inventions more vulnerable to subject matter eligibility challenges. Some observers have concluded that software patents are no longer worth pursuing. We disagree. Although there are real challenges, and patents on some software or other computer-implemented inventions may now be quite difficult (or even impossible) to obtain or enforce, a well-written and well-prosecuted patent application can circumvent many of these obstacles.

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Recent Federal Circuit opinions have provided much-needed clarity and guidance on how to avoid having a patent application rejected or an issued patent invalidated for lack of patent eligibility. For example, in *Enfish v. Microsoft*, the court held that a software patent for a self-referential table was patent-eligible because it was directed to a specific, asserted improvement in computer capabilities.[2] In *BASCOM v. AT&T*, the court held that a software patent on a specific, new customized content filter program on a remote ISP server was eligible where "the patent describes how its particular arrangement of elements is a technical improvement over prior art ways of filtering such content."[3] And, in *McRO v. Bandai*, the court held that a software patent requiring specific rules to render 3-D animations in a specific way was patent-eligible because the use of the rules did not preempt others from animating with generic rules.[4]

These cases highlight the importance of showing how a claimed invention implemented by software (or software in combination with computing hardware) is both different from and provides advantages over prior solutions to a technological problem, and, more broadly, to existing approaches that might be considered well-known, routine, or conventional. In our experience, providing explanations on this point within a patent application can have the effect of making the eligibility requirement a simple threshold issue, like making sure a patent claim is written clearly. Drafting patent claims so that they recite a specific and unconventional way of solving the problems described in the application may be all that is needed to satisfy the eligibility requirement. Of course, in order to strengthen the chances of success, the patent claims should be directed to a technological improvement that solves a technological problem, not to the mere automation of known economic practices or ways of organizing human activity.

The line between what is and what is not patent eligible is becoming clearer — provided you know how to interpret and apply the evolving jurisprudence governing patent-eligibility requirements. Mintz Levin does. It is monitoring the evolving landscape closely and continues to help our software clients successfully navigate through the obstacles they face in obtaining and litigating patents. Mintz Levin's insight comes in part from over a decade of writing and prosecuting patent applications in foreign patent systems that have a more stringent test for the patentability of computer-implemented inventions — one closer to the *Alice* standard now governing patent eligibility in the United States.

Endnotes

1 *Alice Corp. v. CLS Bank Int'l*, 134 S.Ct. 2347 (2014).

2 *Enfish, LLC v. Microsoft Corp.*, 822 F.3d 1327, 1335-36 (Fed. Cir. 2016).

3 *BASCOM Global Internet Servs. v. AT&T Mobility LLC*, 827 F.3d 1341, 1350 (Fed. Cir. 2016).

4 *McRO, Inc. v. Bandai Namco Games Am.*, 837 F.3d 1299, 1315 (Fed. Cir. 2016).

A Balanced Approach to Founder's Equity

BY DANIEL DEWOLF AND SAMUEL ASHER EFFRON

The most successful start-up ventures are companies where the economic interests of the various stakeholders are sufficiently aligned. If an enterprise can find the right balance among the competing interests of the founders, investors, management, and directors, it has a far greater chance of succeeding. If the right balance is not reached, there will be too much time spent on in-fighting instead of being laser focused on accelerating the growth of the enterprise.

Over the years, the pendulum of balance between the founders and the investors has swung back and forth. In certain eras, the investors call the shots and, at other times, the leverage is with the founders. Generally, the investors are willing to invest in the founders provided they have reasonable protections and believe they can make a financial return commensurate with the risk. On the other hand, the founders who create the business are usually very concerned that they will lose control of their "baby."

When this delicate balance favors one side too much, the enterprise has a greater risk of failure. When the VCs take action solely because they can, the enterprise may fail as management and workers will either leave or work less than at full capacity. On the other hand, when a founder has total control, there is a lack of accountability and this too will often lead to disastrous results. A multilateral approach among the parties, where all parties are incentivized to cooperate and collaborate, has a far better chance of creating a successful business enterprise and therefore all stakeholders are more likely to reap the economic benefits.

A few years ago, we proposed a new balanced approach to founder's equity. What we proposed was a new Class E Common Stock for founders that would, in effect, provide some of the protections that Series Seed Preferred investors received. The founders, with Class E Common Stock, would have the right to approve certain major corporate decisions and the right to certain board seats. Unlike the more aggressive founder approach where a founder is given 10 votes for everyone else's one vote, the founder is still accountable and still subject to normal corporate governance rules and practices. But unlike the basic NVCA approach, which is heavily weighted in favor of the investors, with the Class E Common Stock, the founder is provided with some basic rights to protect against certain potentially overreaching actions by investors.

When we started using this capital structure for new companies a few years ago we were concerned that many VCs would require that the founders change its Class E Common Stock into regular common stock as a condition to investing. While we do not have hard data on this, from the anecdotal evidence, it appears that in about half of the subsequent financings, this unique, fair, and equitable structure has been accepted by investors. Further, the companies that have used this balanced approach have all continued to thrive and grow.

We believe our model promotes an atmosphere of collaboration between founders and investors and should, in most instances, lead to better outcomes. Set forth below in its entirety is our original article and proposal:

When accepting money from outside investors, entrepreneurs are generally asked to give up some degree of control over their start-up, exchanging equity in their company for cash. In an effort to minimize the control they relinquish, upon formation of their company, entrepreneurs can grant themselves equity that comes with special rights. These rights, such as special voting privileges or guaranteed board seats, allow founders to maintain control of their company in spite of a dwindling ownership percentage. They may also include special rights that make it possible for a founder to cash out some of his equity prior to an IPO or other exit event.

Investors, of course, may prefer that founders not be granted these special rights, and the extent to which these rights survive a round of financing will be the product of negotiation and leverage between the parties. But even though none of these rights may survive, they can play a crucial role in leveling the playing field heading into negotiations, while also signaling to investors that the founders want to be active collaborators in the growth of the company going forward. A reasonable and balanced approach will also let investors know that the founders will be savvy, but practical, partners. We believe that the special rights granted to founders under our model formation documents are a balanced approach that fairly aligns the interests of founders and investors.

Founder Control

Our model formation documents provide that founders are issued a special class of common stock dubbed the "Entrepreneur's Shares" or "Class E" Common Stock. These shares carry protective provisions, similar to those typically granted to holders of preferred stock, requiring a majority vote of Class E stock for the company to undertake certain actions: (1) amend the Certificate of Incorporation or by-laws of the company, (2) acquire or dispose of capital stock of a subsidiary other than a wholly owned subsidiary, (3) change the size of the board of directors, (4) create an additional class or series of capital stock, or change the authorized number of shares of any class or series of capital stock, and (5) liquidate, merge or consolidate the company.

Class E stock also carries special rights with respect to the company's board of directors. Holders of Class E stock, voting separately from all other stockholders, are entitled to elect a majority of the members of the board of directors serving at any given time, ensuring that at all times the founders will maintain majority control of the board. Further, a unanimous vote of the Class E appointments to the board is required in order for the company to make changes to its stock option plan, or to issue any debt securities.

Notably absent from our formation documents are across-the-board "super-voting" rights for Class E stockholders. Other initial capitalization schemes provide, for example, that founders' shares carry 10-1 voting rights on all matters brought before the stockholders. We believe such a structure is particularly unappealing to investors, who may not want to purchase preferred shares with voting rights dwarfed by those of the founders. Our model, in which all shares carry equal voting rights, promotes an atmosphere of collaboration between founders and investors, while vesting ultimate control in the company in the founders through protective provisions and board seats. While investors may also balk at our model, we believe it appears more reasonable than super-voting provisions at first glance, and will lead to more productive negotiations regarding post-investment control over the company.

Founder Liquidity

As a collateral benefit to our approach, founders holding Class E Common Stock can also enjoy greater liquidity of their shares. Unless they are bought out or the company undertakes an IPO, it can be difficult for founders to convert their equity in a company into cash—investors are rarely willing to buy common stock from a founder during a round of preferred financing. Moreover, if a founder sells his shares of common stock, the strike price for any common stock options will have to be pegged to the consideration he receives. The same effect on option pricing will occur if he sells his common stock back to the company via redemption.

Some structures attempt to solve this problem by issuing to founders a portion of their equity, perhaps 15%, in the form of special convertible stock that converts into whatever class of preferred is being sold in a later round of financing. So, for example, in a Series C Financing, an investor might buy most of its shares of Series C from the company, but will also buy a portion directly from the founder, which purchased shares then automatically convert into Series C. In this manner, the founder is able to take some money off the table.

While appealing, the above approach lacks flexibility for the founder. The founder must decide from the outset how much of his equity in the company should be potentially convertible into preferred stock. If, upon forming the company, he receives 15% of his equity in the form of convertible stock, then that is the maximum amount of equity he can sell for cash in this manner. Once a preferred financing is at hand, it will be too late for the founder to issue himself additional convertible stock.

The above approach also presents problems for investors who may prefer to buy directly from the company for a number of reasons. As a matter of principle, investors likely prefer that their money goes into the working capital of the company that they now own a part of, and not into the founder's pocket. But also, as a regulatory matter, institutional investors relying on the "venture fund" exemption from registration under the Investment Advisors Act may be required to buy shares directly from the company. A purchase of shares from the founder, rather than from the company, would constitute a "non-qualifying investment" under the venture fund exemption. A fund will lose its exemption if over 20% of its portfolio consists of such non-qualifying investments.

Our approach provides a different path to founder liquidity that avoids many of these problems. Following a round of financing, the company can simply redeem a portion of the founder's Series E shares for cash. Because Series E shares carry rights and preferences different from common stock, this redemption will NOT affect common stock option pricing. Moreover, the founder's potential for liquidity is not "baked in" to his equity from the start, as it is with convertible stock. When the time is appropriate, the founder can seek redemption of any portion of his Series E shares.

From the investors' perspective, the redemption approach avoids venture fund exemption issues, as investors can still buy their preferred shares directly from the company. And redemption provides flexibility to find the appropriate balance.

Many entrepreneurs, reluctant to get bogged down in complexities or scare wary investors, may be tempted to set up their company with a straightforward, single class capitalization. But if drafted with a delicate touch, a more developed initial capitalization structure can, we believe, give entrepreneurs greater flexibility and control without turning off future investors.

To summarize, we believe start-ups should be set up as follows:

(a) Class A Common reserved for employees, advisors and other issuances of common stock (including common stock underlying options).

(b) Class E (Entrepreneur) Common issued to the founders. Class E Common has certain protective provisions analogous to Preferred Stock and the right to designate a certain number of board members.

(c) Preferred Stock for investors.

Innovator Profile: BetterPT

BetterPT Digitalizes the Physical Therapy Industry

Recognizing that physical therapy will always be in demand, **Dr. Stephen Fealy MD**, a leading orthopedic surgeon at the *Hospital for Special Surgery* (HSS), and **Greg Peters**, a leading health and fitness expert, joined forces to make the overall physical therapy industry and experience more effective and efficient, thus BetterPT was conceived.

BetterPT (www.betterPT.com) is a Platform As A Service (PaaS) that connects the patient and the physical therapist through simple, user-friendly technology to give the patient the best possible treatment outcome with a personal and convenient approach. Through the HIPAA compliant BetterPT mobile app, patients can use geo-location to find a therapist, book an appointment to their desired location, add their condition and pay for their treatment, creating an entirely personalized physical therapy experience.

Companies like Uber have created the marketplace for the on-demand lifestyle. Incremental change in health care delivery is on the horizon and companies continue to explore frictionless care options. “After 15 years of experience in health and fitness, plus in-depth knowledge of the PT eco-system, we have identified a need, addressed the frustrations and struggles of the patient, and are now providing a solution to the logistics of making PT a better experience,” explains **Greg Peters**, Co-founder and CEO of BetterPT. “Like Uber changed the taxi business, we intend to change how the physical therapy industry operates.”

BetterPT revolves entirely around improving the physical therapy experience by placing high emphasis on convenience to both the patient and physical therapists. Patients can seamlessly manage their treatment history, including access to the necessary information for insurance reimbursement. The app even allows direct communication between the physical therapist and patient through its in-app messaging.

BetterPT is a disruptive technology that preserves the relationship between provider and patient while benefitting both parties. The BetterPT app enables New York City physical therapy clinics to extend their brand and treatment outside of the traditional brick and mortar locations, thereby capturing additional revenue without added cost. The platform software allows individual physical therapists and large multisite PT clinics to manage their day-to-day operations efficiently through mobile and desktop applications.

Outpatient rehabilitation is currently a $29.6 billion industry. Traditional musculoskeletal physical therapy (PT) accounts for $26.6 billion and 89.8% of all outpatient rehabilitation spending. Industry revenue is forecasted to grow at an annualized rate of 6.8% to approximately $42 billion in 2020. As it enters an industry with potentially exponential growth, BetterPT looks to not only cater to the needs of those seeking physical therapy, but to ensure a smooth process between patient and physical therapist.

BETTER PT INC closed its initial $1.5M Series Seed Round led by **Loeb Holding Corp.**, one of the last privately held independent investment banking enterprises on Wall Street. “I believe BetterPT will improve both the patient’s and therapist’s experience on many fronts,” states Co-founder and Chief Medical Officer **Dr.**

Stephen Fealy. “This is an incremental improvement to the traditional patient/therapist experience. One in which the patient will be able to book a therapy visit through an app and the physical therapist can simultaneously provide the best care for their patients.” For more information, see the recent article in MobiHealthnews.

Upcoming Events

New York

March 29-30: DataDisrupt Conference

April 6: TechCrunch Takes Manhattan 2017

April 7: TieCon New York 2017

April 18: TechDay

April 24-28: FinTech Week 2017

April 26: Health and Bio Technology Summit

May 2-3: Bloomberg Breakaway

May 4: Landmark CIO Summit 2017

May 7-9: Behave Annual 2017

May 15-17: TechCrunch Disrupt NY 2017

May 22-24: Consensus 2017

Boston

March 30: 2017 MITX DesignTech Summit

March 30: State of Advanced Energy Webinar

May 11: Xconomy EXOME Presents: What's Hot in Boston Biotech

May 22-25: LiveWorx 17

San Diego

March 22-24: Social Media Marketing World

April 18-20: ERE Recruiting Conference

April 19: Xconomy Forum: Human Impact of Innovation

San Francisco

March 23: The U.A.E.'s Startup Ecosystem and Opportunities for U.S. Investors

March 27-28: EmTech Digital

March 28-29: Bluetooth World 2017

March 29: Emerging Technologies and Torts of the Future

April 20-21: DevPulseCon

April 23-24: Forbes CIO Summit

May 16-17: Mobile Venture Summit

May 17-19: Google I/O

Washington, DC

March 27: Oracle Code 2017

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