

START-UP HANDBOOK

<u>INTRODUCTION</u>	3
<u>POLICIES AND PROCEDURES RELATING TO START-UPS</u>	3
<u>PHASE ONE: PRELIMINARY APPROVAL</u>	4
<i><u>AS YOU KNOW, YOU SHOULD REPORT ANY INVENTION YOU MAKE TO THE APPROPRIATE OFFICE AT YOUR HOST INSTITUTION .</u></i>	4
<i><u>THE HOST INSTITUTION DECIDES WHETHER COMMERCIALIZATION THROUGH A START-UP IS APPROPRIATE.</u></i>	4
<i><u>THE HHMI SCIENCE DEPARTMENT DECIDES WHETHER LICENSING YOUR INVENTION TO A START-UP IS ACCEPTABLE TO HHMI UNDER THE CIRCUMSTANCES.</u></i>	4
<u>PHASE TWO: THE START-UP’S INCEPTION</u>	6
<i><u>ACTIVITIES AS A FOUNDER.</u></i>	6
<i><u>STOCK OWNERSHIP AS A FOUNDER.</u></i>	7
<i><u>HHMI’S POLICY ON OWNERSHIP OF EQUITY.</u></i>	7
<u>PHASE THREE: THE CONSULTING ARRANGEMENT</u>	8
<u>PHASE FOUR: THE LICENSE ARRANGEMENT</u>	10
<i><u>SCOPE OF LICENSED PATENT RIGHTS .</u></i>	10
<i><u>CASH V. STOCK LICENSE CONSIDERATION .</u></i>	11
<u>OTHER ISSUES RELATING TO START-UPS</u>	13
<i><u>RESEARCH COLLABORATIONS .</u></i>	13
<i><u>GIFTS .</u></i>	13

Introduction

An investigator's involvement in a start-up company raises many issues that implicate the Institute's policies. For example, a start-up typically will want a founder or inventor of licensed technology to be actively involved in the company's research and development program and may seek to compensate him or her with a substantial equity stake in the company. If an Institute investigator is a founder or inventor, or will otherwise act as a consultant to the start-up company, these arrangements must be made consistent with the Institute's policies in the areas of intellectual property, licensing, consulting, and conflicts of interest.

The Institute's policies in these areas are described generally in the guide ["What You Should Know About Intellectual Property, Research Collaborations, Material Transfers, Consulting, and Confidential Disclosure Agreements."](#) This Start-up Handbook is intended to supplement the guide with more detailed information on the Institute's policies relating to start-up companies. We recognize that each start-up proposal has its own unique facts and circumstances. This handbook is intended to provide you with information that you can use to ensure that your involvement with a start-up is structured in a manner consistent with the Institute's policies.

We cannot overstate the importance of making the appropriate host institution and company representatives aware of the Institute's policies early in the process. We urge you to share this handbook with the appropriate individuals, particularly those at your host institution and the company, to inform them of the Institute's policies as soon as you begin to discuss your involvement with a start-up company.

Policies and Procedures Relating to Start-Ups

This handbook divides the Institute's review of a start-up proposal into various phases. However, apart from the first phase -- obtaining preliminary Institute approval to pursue a start-up if the start-up expects to license technology you developed from the host institution -- many of the subsequent phases can occur simultaneously. For example, after the Institute has given its preliminary approval to pursue a start-up, the [Institute attorney responsible for your site](#) may review a proposed consulting agreement at the same time that he or she is

reviewing a proposed license. The timing and order of much of what occurs after the Institute's preliminary review of a start-up proposal will depend on how quickly the company obtains funding, assembles its scientific and business staff, and commences operations, and on when license and consulting agreements are completed and submitted for Institute approval.

Phase One: Preliminary Approval

As you know, you should report any invention you make to the appropriate office at your host institution. That office will inform the Institute of your invention. After the Institute receives the invention disclosure, you will be asked to execute an assignment of your rights in the invention to the Institute, and subsequently, you will receive a document appointing you as the Institute's agent for the purpose of assigning the Institute's rights in the invention to your host institution.

The host institution decides whether commercialization through a start-up is appropriate. After you have disclosed an invention to your host institution, you and the appropriate host representative(s) may discuss strategies for the most efficient method of making the best possible products relating to your invention available for public use. If your host institution concludes after considering a range of options that the best way of achieving the goal of disseminating your invention in the public interest is through a license to a start-up company, you should inform the [Institute attorney responsible for your site](#) that the host is considering such a license.

The HHMI Science Department decides whether licensing your invention to a start-up is acceptable to HHMI under the circumstances. If it is proposed that a start-up company license technology you developed and also use your services as a consultant, it is important that the company's research be easily distinguishable from the ongoing work in your Institute laboratory. All consulting arrangements must provide for keeping your Institute research (and resulting intellectual property) separate from activities you undertake as a consultant for the company (and any intellectual property resulting from those activities). If there is too great an overlap between the company's research and your HHMI research, the necessary separation cannot be maintained.

Thus, the first step in the Institute's review of a start-up proposal is an initial determination by the Science Department that the company's scientific program will stand separate and apart from your research as an Institute investigator. The

Institute has developed a [Start-Up Company/Consulting Questionnaire \(GC-450\)](#) to help in making this determination. If you propose to enter into a relationship -- typically as a founder and consultant -- with a start-up company, you should complete and forward this questionnaire and copies of all related documents requested in the questionnaire, including the start-up company's business plan, to the [Institute attorney responsible for your site](#). Please remember in this regard that HHMI treats as consulting virtually every type of activity for a company for which you are to be compensated, whether in cash, stock, or otherwise.

Factors relevant to the initial analysis of whether the research in your laboratory and the company's research are easily distinguishable include the nature of the research being conducted in your and the company's laboratories, the company's plans to hire its own scientific staff with expertise to develop any inventions that will be licensed to it, its timetable for recruiting key scientific personnel and purchasing laboratory equipment, its expectations with respect to licensing existing technology, and its expectations concerning licensing follow-on technology that may be developed in the future. The company's expectations with respect to your role in the company also are very important to this analysis. Because much of this information may be found in the company's business plan, if the company does not have a formal business plan when you return the start-up questionnaire to the Institute attorney responsible for your site, you should submit the business plan as soon as a draft is available. The Institute's review of the business plan will focus on the plan's description of your role in the company's research. The business plan can accurately describe your role as a founder and scientific advisor, but it must avoid creating any implication that you will be engaged in research on behalf of the company.

Your completed questionnaire and relevant documents relating to the start-up will be reviewed both by the Institute attorney who is responsible for your site and by the Science Department. They will then arrange a phone conference with you and the licensing officer at your host institution, if appropriate. The phone conference will allow for discussion of any issues raised in the questionnaire or in the documents you provide, and will help all parties understand the start-up's history and goals, the roles of various individuals, and expectations for the future. The Science Department will then make the threshold determination about whether there is sufficient distance between the company's and your Institute research to make your involvement in the start-up company feasible. If the Science Department is comfortable that the company's scientific program is not dependent

upon your Institute research or your involvement in the company's scientific management to a degree inconsistent with the Institute's consulting policies, it will move your proposal to the next stage of the Institute's review. You will also be informed if the Science Department concludes that the extent of overlap between the company's research and your Institute research makes a start-up company problematic.

Phase Two: The Start-Up's Inception

Once a preliminary determination has been made that it is feasible to separate your involvement with the company from your Institute research, the focus of the Institute's review of the start-up proposal shifts to an evaluation of your proposed role in the company.

Activities as a founder. As mentioned above, the Institute's policies allow you to consult for private companies. However, your activities as a consultant cannot commence until the Institute approves a formal consulting agreement that includes appropriate provisions satisfying HHMI's consulting requirements. There is likely to be a period of time following the Institute's preliminary approval of a proposal to license technology to a start-up during which it would be premature to submit your consulting arrangement with the company to the Institute for approval. During this period the company will be assembling its scientific and management teams, securing financing, obtaining laboratory and office space, and taking other steps towards becoming an operational entity. Until your consulting agreement has been approved by the Institute, however, your activities with respect to the company must be extremely limited.

From the company's inception, the company must have individuals other than you acting as its representatives. You should not at any time function as, or be identified in corporate documents as, an officer or director of the company. Individuals other than yourself should be undertaking the steps that transform the company into an operating business. Your activities during this initial phase of the company's development must be limited to review of strategic plans (you should not be drafting them) and occasional discussions with company representatives about the company's progress in recruiting scientific and business personnel, obtaining licenses, etc. The company's other founders and potential investors should be made aware at the outset of the limited nature of your involvement with the company prior to and following the Institute's approval of your consulting agreement.

Throughout the course of your relationship with the company, you must not provide the company with knowledge of or access to the results of Institute research prior to the time that these results are made generally known to the scientific community at large. If you have information that you would freely discuss outside of your institution at seminars or in informal scientific discussions, however, you may also freely share that information with the company. If, as to a particular matter, you are unsure whether the matter is something you should discuss with the company, please contact the [Institute attorney responsible for your site](#).

Stock ownership as a founder. You may be offered an opportunity to acquire stock in the company during this preliminary phase of its development. Subject to the equity ownership limitation discussed below, you can be issued stock in the company before your consulting agreement has been approved by the Institute, provided your activities with respect to the company are limited in the manner described in the previous section. Please note that as discussed below, the date you first acquire ownership of any company equity in a start-up company is the start date of the “grace period” of up to one year during which you may own more than 5% of the company’s equity (regardless of whether there is a consulting agreement in place on that date).

HHMI’s policy on ownership of equity. The Institute’s limitation on equity ownership is a fundamental element of its efforts to minimize conflicts that could undermine or appear to undermine its investigators’ academic integrity and independence. The limitation is set at a level that is intended to ensure that Institute investigators do not have a “significant equity interest” in the company that could or could appear to influence their scientific judgment. Except in the context of start-up companies, the Institute considers an investigator’s interest of more than 5% of the equity of any company (including all stock, options, and similar rights, whether held directly or indirectly, and whether received as compensation for consulting services, an inventor’s share of royalties, or otherwise) for which he or she consults as per se significant and therefore prohibited. Because as a practical matter this 5% rule is more likely to have a limiting effect in the start-up context, however, the Institute’s [policy on ownership of equity in start-up companies](#) helps to moderate the impact of the Institute’s 5% limit on equity ownership when an investigator founds or consults for a start-up company. Under this policy, for a period of not longer than one year from the date you first acquire ownership of any securities of the start-up company, you may own up to 20% of

any class of the company's equity securities; however, in no event may HHMI investigators as a group own more than 40% of a start-up company's equity. By the end of the one-year period, your ownership must be reduced to not more than 5% of the relevant class of equity securities of the start-up company. If there is a "significant event" earlier than the end of the one-year period, for example, an initial public offering of the company's stock or an acquisition or merger of the company, your ownership must be reduced to not more than 5% before the occurrence of that event.

Please note that this is only a summary of the policy. If you proceed with your involvement with a start-up company, you will need to review carefully the [policy on ownership of equity](#); [instructions for calculating equity ownership in companies](#) are also available. Please direct any questions about the policy and instructions to the [Institute attorney responsible for your site](#).

The limitation on equity ownership applies to ownership of shares issued from any company affiliated with a start-up company as well as to ownership of shares issued by the start-up itself. It also applies to your direct and indirect ownership of equity securities. Securities issued or issuable to members of your immediate family are considered to be indirectly owned by you for purposes of this calculation and so must be taken into account. In addition, the calculation also considers any securities allocated or allocable to you under your host institution's inventorship policies, as royalties under a license granted by the host to the company. Accordingly, if you are entitled to additional shares of the company as a result of your role as an inventor of technology licensed by your host institution to the company, such inventor's shares must also be taken into account in satisfying the Institute's limitation on equity ownership. If inventor's or other indirectly owned shares have not been taken into account in calculating your equity ownership in the company, please contact your Institute attorney regarding special arrangements that will have to be made for the disposition of those shares. See [cash v. stock license consideration](#), below.

Phase Three: The Consulting Arrangement

It is often the case that a start-up company seeks to have the inventor(s) of the licensed technology take an active role in the company's scientific efforts in developing the technology as a consultant. This expectation can conflict with a number of the Institute's policies. First, each investigator is limited to not more

than 36 days of consulting annually and in some cases, depending on his/her other responsibilities, an investigator may not be able to commit as much as 36 days per year to consulting. Moreover, an investigator's contribution as a consultant is limited to the exchange of ideas. He or she may not perform research for the company or oversee the performance of company research by others. It is therefore important that the start-up company be able to demonstrate that it has a scientific staff capable of conducting the company's research and will be looking to the investigator only for those types of services that Institute policies permit. In addition, the Institute will not approve a consulting agreement that calls for the investigator to sit on the board of directors of a start-up or serve as an officer of a company.

Once the company has progressed to a point where it has scientific and other management personnel, laboratory space and equipment, etc., a proposed consulting agreement between you and the company can be submitted to the Institute for approval. The appropriate company representative should already be aware of the need for Institute approval and should have been provided with the [Institute's model form of consulting agreement \(GC-400\)](#).

The provisions of the Institute's model agreement that appear in bold-faced, italicized print are required to be included in your consulting agreement. These provisions limit in a manner consistent with Institute policies the scope of your activities for the company and its access to intellectual property developed in your laboratory. The company's use of the rest of our model agreement as the basis for your consulting agreement is not required, but our familiarity with it usually enables us to complete our review more quickly than when the company uses its own form. If the company prefers, the Institute has a [consulting "staple-on" agreement \(GC-420\)](#) that may be attached to the company's agreement.

As noted above, the Institute restricts the maximum number of days per year that an investigator can consult for private companies to 36 days annually. If you have substantial commitments as a faculty member or other non-HHMI research-related obligations, the 36-day maximum may be reduced. You should review your other consulting commitments and determine whether any modifications to those consulting agreements are necessary as a result of your decision to consult for the start-up company.

Your compensation as a consultant can include cash and/or equity. However, your equity ownership is subject to the equity ownership limitation discussed above.

You or the company should send the [Institute attorney responsible for your site](#) copies of any documents you are asked to sign in connection with your compensation as a consultant (e.g., stock option or stock purchase agreements, stockholders agreements, registration rights agreements, and the like).

After the Institute attorney is satisfied that the Institute's interests are adequately protected in your consulting agreement, he or she will submit the agreement for formal Institute approval. Once you have received an approval letter from the Institute, you are free to execute the consulting agreement and begin consulting for the company, assuming the agreement is acceptable to you. Please note that as with any consulting agreement, the Institute's review is solely to consider whether the consulting arrangement conforms to Institute policies. Investigators are encouraged to seek their own legal counsel to advise them of their rights and obligations under a proposed consulting arrangement and as they may relate to other consulting arrangements already in existence. Investigators also are responsible for complying with any host institution policies or procedures relating to consulting activities.

Phase Four: The License Arrangement

The Institute's policies as they apply to licenses to start-ups are similar to its policies with respect to licenses to other companies. The Institute leaves the task of negotiating licenses to its host institutions (subject to demonstration in the start-up context that the host institution has concluded after considering a range of options that the best way of disseminating the invention in the public interest is through a license to a start-up). The Institute, however, reviews licenses between a host institution and a company before the license is finalized to confirm that the scope of rights granted to the licensee does not provide the licensee with undue access to future research from the Institute laboratory and that various provisions required under Institute policy or by the Institute's collaborative arrangements with its host institutions have been included in the license.

Scope of licensed patent rights. When a company is seeking capital to fund an enterprise based on a single technology or a small number of related technologies, it understandably may seek to lock up rights in all of the inventor's further developments in the field. HHMI's policy regarding pre-commitment of rights in future technology makes it unlikely that such a broad grant of license rights will be approved with respect to technology developed in Institute labs. It is therefore important that the host institution representative negotiating any license or option

agreements with the start-up company work closely with the Institute attorney assigned to your site in order to assure that all parties are aware of the scope of rights available to a potential licensee.

The company's rights in future inventions must be limited to the claims of patent applications covering future inventions that are specifically addressed to the subject matter of the existing patent applications being licensed. There can be no explicit or implicit promise that future technologies which you may develop as an Institute investigator will be licensed to the company. The Institute expects that your host institution will use all reasonable efforts to determine the most appropriate licensee for your future inventions by seeking the interest of any company that is well suited to license the inventions. This does not preclude the start-up from licensing such future inventions; it simply means that other potential licensees should have an opportunity to bid as well.

It is important for your host institution and the company to be aware of the Institute's policies with respect to licensing early in their license negotiations. Host institutions have been provided with a guide summarizing the Institute's licensing policies and required license provisions ([Intellectual Property and HHMI Employees: A Guide for Host Institutions](#)). Please advise the appropriate representative at your host institution to provide the [Institute attorney responsible for your site](#) with the term sheet (if one has been done) for a license of any of your discoveries to a start-up before the license is finalized. The host should also send a close-to-final draft of the license agreement to the Institute attorney responsible for your site for review and comment prior to its execution.

Cash v. stock license consideration. Licenses of intellectual property developed in Institute laboratories may provide for royalties or other compensation payable in cash, securities, or both. The Institute strongly encourages the receipt only of cash consideration in licenses of intellectual property you have developed in recognition of the possible conflict of interest (actual or apparent) that may arise by holding stock in a licensee company. Nevertheless, the Institute acknowledges that in some situations it may be necessary for a host institution to accept securities as consideration for a license. In particular, the Institute recognizes that in license negotiations with a start-up company, the company may not be in a position to pay the host institution/licensor an upfront license fee, and that for this and other reasons, a license between the host institution and a start-up may provide for a grant of stock in the company to the host institution. The Institute's [policy on the](#)

[receipt of royalties](#) in the form of securities sets forth the Institute's procedures for the handling of its portion of securities issued in connection with a license of such intellectual property.

One issue that arises from a host institution's receipt of stock as consideration for a license relates to distribution of the inventor's share of the license income. As discussed above, the Institute's policies limit the amount of equity that an investigator can hold in a company at any time. An HHMI investigator cannot receive more than that amount of shares for any reason. Consequently, you cannot receive shares of a company's stock under the host institution's inventorship policies if it would cause you to hold more shares than allowed under the Institute's policies. See the Institute's [policy on ownership of equity](#) and [instructions for calculating equity ownership in companies](#).

Investigators occasionally ask whether they can contribute to their laboratory royalties paid to them as an inventor. If royalties from a license are the source of a substantial portion of a laboratory's funding, however, it may create an appearance that the licensee is funding research in the laboratory, which is prohibited under the Institute's policies, particularly because the licensee is likely to have limited rights in future technology developed in the laboratory as a result of its license of existing technology. In order to avoid any such appearance, the Institute limits the amount of royalties from a license that can be contributed to an Institute laboratory. If you are interested in contributing royalties to your laboratory, you should contact the [Institute attorney responsible for your site](#) for further guidance.

Other Issues Relating to Start-Ups

Research collaborations. The Institute generally will not permit its investigators to collaborate with companies for which they consult. This restriction is particularly important in the case of start-ups because of heightened concern about the separation of Institute and company research.

Gifts. Where technology from an Institute laboratory has been licensed to a company, it is difficult to avoid an appearance that the laboratory is performing sponsored research for the company if the company makes a gift to the laboratory. For this reason, Institute laboratories generally are not permitted to accept gifts from companies, including start-up companies, that have licensed an invention arising from the laboratory.