

HHMI START-UP HANDBOOK FOR HHMI LABORATORY HEADS AT HOST-BASED SITES

Introduction

As explained in [HHMI Policy SC-520, Consulting for and Equity Ownership in Start-up and Other Private Companies](#), HHMI believes that start-up companies can play an important role in translating basic research discoveries made in HHMI and other academic laboratories into effective therapies and diagnostic tools. For this reason, HHMI allows its HHMI Investigators to found companies and consult for them. At the same time, HHMI recognizes that a laboratory head's relationship with and services on behalf of a start-up company may be more extensive than the relationship and services associated with other types of consulting. For example, the range of services that a founder might provide in the initial stages of a start-up might include providing assistance in securing financing, identifying key personnel, and developing business plans. HHMI has prepared this Start-up Handbook to supplement [HHMI Policy SC-520](#) with more detailed information on HHMI's policies relating to start-up companies for laboratory heads at host-based sites.

For purposes of this handbook the terms "start-up" and "start-up company" have the same meaning as in the policy. The 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 HHMI's policies. We urge you to share this handbook with the appropriate individuals, particularly those at your host institution and the company, to inform them of HHMI's policies as soon as you begin to discuss your involvement with a start-up company.

Policies and Procedures Relating to Start-Ups

You will find considerable information about HHMI's approach to start-ups in [HHMI Policy SC-520](#). Please familiarize yourself with that policy before taking any steps to form a company. This handbook focuses more on the mechanics of HHMI's review of

your proposal, the calculation of your equity ownership interest, and your disclosure obligations.

Preliminary Steps

Please report any invention you make to the appropriate office at your host institution.

That office will inform HHMI of your invention. After HHMI receives the invention disclosure, you will be asked to execute an assignment of your rights in the invention to HHMI, and subsequently, you will receive a document appointing you as HHMI's agent for assigning 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 host tech transfer personnel may discuss strategies for commercializing your invention. If your host institution concludes that the best way to commercialize your invention is through a license to a start-up company, you should inform your [HHMI attorney](#) that the host is considering such a license.

The HHMI Science Department reviews start-up proposals to confirm that there is a clear distinction between research in your HHMI lab and the start-up's scientific program.

As discussed in [HHMI Policy SC-500, Consulting for Companies - General Policy](#), consulting for companies is outside the scope of a laboratory head's HHMI employment. Accordingly, the first step in HHMI'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 HHMI laboratory head. HHMI has developed a [Start-Up Company Consulting Questionnaire](#) 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 this questionnaire on the [HHMI Investigator Portal](#) and attach copies of all related documents requested in the questionnaire, including the start-up company's business plan. In addition, you should provide any information relating to your participation in the start-up that you have submitted to your host institution's conflict of interest or similar committee.

Factors that HHMI's Science Department considers in its 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 for licensing existing technology, and its and your expectations concerning licensing follow-on technology that may be developed in the future. Your and the company's expectations regarding your role in the company also are very important considerations. Because information about many of these factors may be found in the company's business plan, please provide your [HHMI attorney](#) with a copy of the business plan as soon as a draft is available. HHMI will review your completed questionnaire and relevant documents relating to the start-up. Please note that you are responsible for updating the information you provide to HHMI in connection with its review of your proposal so that HHMI is kept apprised in a timely manner of the company's progress following formation and your host institution's review of any conflict of interest concerns.

Your Role as a Founder

Once a preliminary determination has been made that it is feasible to separate your involvement with the company from your HHMI research, the focus of HHMI's review of the start-up proposal shifts to an evaluation of your proposed role in the company. As described in [HHMI Policy SC-500, Consulting for Companies - General Policy](#), HHMI considers consulting activity to include nearly any service on behalf of a company, including service as a founder of a company.

Activities as a founder. From soon after the company's inception, the company must have individuals other than you acting as its representatives. You should not at any time function, or be identified in corporate documents, as an officer of the company. Additionally, you should not be identified as a director of the company unless your

service as a member of the board of directors has been approved in accordance with [HHMI Policy SC-530, Service as a Member of a Company's Board of Directors](#).

Taking into account the factors described in that policy, ordinarily HHMI will not approve service on the board of directors of a start-up company formed around technology developed by your laboratory. Your activities during the initial phase of the company's development can include assistance with the development of strategic plans and discussions with company representatives about recruiting scientific and business personnel, obtaining licenses, etc., but individuals other than you should have primary responsibility for transforming the company into an operating business. If you have information that you would freely discuss outside of your institution at seminars or in informal scientific discussions, you may freely share that information with the company. However, you must not provide the company with knowledge of, or access to, the results of HHMI research prior to the time that these results are made generally known to the scientific community at large. If, as to a particular matter, you are unsure whether the matter is something you should discuss with the company, please contact your [HHMI attorney](#). 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 as a founder/consultant.

Stock ownership as a founder. You will likely be offered an opportunity to acquire stock in the start-up company. Your stock ownership must at all times comply with HHMI's policy regarding equity ownership in start-up companies.

As explained in greater detail in [HHMI Policy SC-520](#), for a period of not longer than one year from the date you first acquire ownership of any securities of the start-up company, HHMI rules generally place no limits on the amount of the company's equity you may own. The one-year period is intended to allow time for you to determine whether other people are interested in investing in the start-up. By the end of the one-year period (or earlier if a Significant Corporate Event, as described below, occurs), your ownership must be reduced to less than a "controlling interest" of the start-up company. [HHMI Policy SC-520](#) describes in detail what constitutes a controlling interest; generally, it means that you own or control 50 percent or more of the company's voting securities or

otherwise control the management or operations of the company. The requirement of owning less than a controlling interest in the start-up after a year may be temporarily waived if HHMI's Vice President and Chief Scientific Officer concludes that there are compelling reasons why continued ownership of a controlling interest should be permitted beyond the one-year period. Requests for such a waiver must be submitted in writing to HHMI's Vice President and Chief Scientific Officer at least 30 days prior to the end of the first year of your stock ownership. We urge you to keep in mind HHMI's equity ownership rules, particularly the requirements that apply after one year, as you are contemplating forming a company.

If your start-up experiences a "Significant Corporate Event," your equity ownership must be reduced so that, immediately following the event, you own no more than 5 percent of the company's stock. The occurrence of any one of the following is considered by HHMI to be a "Significant Corporate Event":

- (i) the company's securities become publicly traded (e.g., as a result of an initial public offering by the company of shares of its stock);
- (ii) there is a change in control of the company (examples of change in control transactions include stock acquisitions, reorganizations, mergers, consolidations or other business transactions that change the majority ownership of the company but do not include sales of stock for the purpose of raising capital for the company); or
- (iii) HHMI determines that one or more transactions similar in significance to those described in clauses (i) or (ii) have occurred.

Please note that the 5 percent limit applies immediately following a Significant Corporate Event, even if the event occurs within your first year of owning stock in the company. You are responsible for keeping your [HHMI attorney](#) apprised of Significant Corporate Events and other major transactions and events affecting the company.

As explained in [HHMI Policy SC-520](#), for purposes of applying HHMI's limits on equity ownership, HHMI generally treats you as the owner of all shares of the company of which you would be considered the "beneficial owner" under United States Securities and Exchange Commission rules (specifically, SEC Rule 13d-3, Determination of Beneficial Ownership under the Exchange Act of 1934, as amended), regardless of whether the company is a private or public company. The start-up company's counsel

will be able to assist you in this analysis, including review of whether you are the “beneficial owner” under the securities rules of any equity taken by your host institution from the company as a component of royalties for a license of intellectual property to which you contributed. In general, in addition to any shares that you own directly, you are considered to own indirect holdings, such as shares held by a trust or partnership of which you are a beneficiary or partner as well as any shares that you can acquire through the exercise of options or warrants that are exercisable within 60 days of the calculation date. You also are treated as owning any shares beneficially owned by your immediate family members.

Please note that this is only a summary of HHMI’s equity ownership policy. You and the company will need to review [HHMI Policy SC-520](#) carefully. Please direct any questions about the policy to your [HHMI attorney](#).

The Consulting Agreement

Once the company has management personnel who can represent the company in negotiating the terms of your consulting agreement, a proposed consulting agreement between you and the company can be submitted to HHMI for approval. Your agreement either must be in the form of HHMI’s [model consulting agreement](#) or include HHMI’s [Uniform Consulting Agreement Provisions](#) (the “Uniform Provisions”). HHMI’s model consulting agreement and the Uniform Provisions are available at: [Research Policies - Consulting](#). You should make the appropriate company representatives aware of HHMI’s requirements with respect to consulting agreements early in the process. ***Only consulting arrangements that use HHMI’s model consulting agreement or which include the Uniform Provisions will be approved by HHMI.***

Your relationship with a start-up as a consultant is subject to all of HHMI’s requirements with respect to consulting generally. As explained in [HHMI Policy SC-500, Consulting for Companies – General Policy](#), HHMI restricts the maximum number of days per year that an investigator can consult for private companies. Specifically, you must adhere to the host institution’s limits on the amount of time that you may spend on consulting activities.

If the host institution does not have a stated limit on the time a laboratory head may spend annually on such activities, then you may engage in up to 36 days of consulting activity each year. For purposes of the annual time limit, only the actual number of days spent consulting for companies during each year need be counted. As you begin to structure your relationship with a start-up, 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 (subject to the limitations described above). Incentive compensation based on company revenues, profits, product development, or other measures of company success generally is not allowed under HHMI policies. You or the company should send your [HHMI attorney](#) 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, voting agreements, registration rights agreements, and the like).

After your [HHMI attorney](#) is satisfied that the proposed relationship is consistent with HHMI policies, he or she will submit the agreement for formal HHMI approval. Once you have received approval from HHMI, 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, HHMI's review is solely to consider whether the consulting arrangement conforms to HHMI's policies. You are encouraged to seek your own legal counsel to advise you of your rights and obligations under a proposed consulting arrangement and as they may relate to other consulting arrangements already in existence. You also are responsible for complying with any host institution policies or procedures relating to consulting activities.

Annual Reporting to HHMI

Following approval of a proposed consulting relationship with a start-up, if you own more than a controlling interest in the company you are required to report annually to HHMI's Office of the General Counsel regarding, among other things, the progress of the company in pursuing its business plan, the relationship between research occurring in

your HHMI laboratory and the company's scientific program, and your ongoing equity interest in the company. In all cases, you must promptly report to your [HHMI attorney](#) any Significant Corporate Events affecting the company, any matters that are required to be disclosed to your host institution, and any changes in circumstances that could give rise to conflict of interest concerns (e.g., the company proposes to hire a member of your immediate family as an employee or you are asked to sign a voting rights agreement).

HHMI retains discretion to require you to take steps to HHMI's satisfaction to resolve any conflicts of interests or other issues arising in your consulting relationship, even if you initially received HHMI approval.

The License Arrangement

As you are putting in place your consulting agreement with the company, your host technology transfer office may be concurrently negotiating the terms of a license with the start-up. HHMI's policies as they apply to licenses to start-ups are similar to its policies for licenses to other companies. HHMI largely leaves the task of negotiating licenses to its host institutions. Before the license is finalized, HHMI will review it to confirm that the scope of rights granted to the licensee does not provide it with undue access to future research from the HHMI laboratory and that terms required under HHMI policy or by HHMI's collaborative arrangements with its host institutions have been included in the license.

Scope of licensed patent rights. It is important that the host institution representative negotiating any license or option agreements with the start-up company work closely with the [HHMI attorney responsible for reviewing licenses](#) at your site in order to assure that all parties are aware of the scope of rights available to a potential licensee. Specifically, 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 HHMI employee will be licensed to the company. For a more detailed explanation of HHMI's

requirements with respect to licensing, please refer to [HHMI Policy SC-610, Licensing by Host Institutions to Companies](#).

We urge you to make the company aware of HHMI's policies early in your start-up discussions. In addition, please ask the appropriate representative at your host institution to provide the [HHMI attorney responsible for reviewing licenses](#) at 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 [HHMI attorney](#) for review and comment prior to its execution.

Cash v. stock license consideration. Licenses of intellectual property developed in HHMI laboratories may provide for royalties or other compensation payable in cash, securities, or both. HHMI encourages the receipt only of cash consideration in licenses of intellectual property you have developed because of the possible conflict of interest (actual or apparent) that may arise by holding stock in a licensee company. Nevertheless, HHMI acknowledges that in some situations a host institution may accept securities as consideration for a license. For example, 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. In those cases, a license between the host institution and a start-up may provide for a grant of stock in the company to the host institution. [HHMI Policy SC-610](#) explains HHMI's procedures for distributing royalty income to HHMI where the host institution receives stock under the license; HHMI does not hold equity of companies founded by its host institution-based laboratory heads.

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, HHMI's policies place limits on the amount of equity that an investigator can hold in a company and the limits apply regardless of how the stock was received. 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 HHMI's policies.

Laboratory heads 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 your start-up is funding research in the laboratory, which is prohibited under HHMI's policies. In order to avoid any such appearance, HHMI limits the amount of royalties from a license that can be contributed to an HHMI laboratory. If you are interested in contributing royalties to your laboratory, you should contact your [HHMI attorney](#) for further guidance.

Other Issues Relating to Start-Ups

Research collaborations. HHMI generally will not permit its investigators to collaborate with companies for which they consult. This restriction applies as a prohibition in the case of start-ups because of heightened concern about the separation of HHMI and company research.

Company Funding. [HHMI Policy SC-350, Company Funding Arrangements – Host-based Sites](#) provides that funding from a given company for an investigator's laboratory is not permitted if the investigator consults for that company or owns more than 5 percent of that company's equity. Thus, investigators may not receive company funding in any form (gift, grant, sponsored research) from start-up companies for which they consult or in which they own more than 5 percent of the company's equity. Please refer to [HHMI Policy SC-350, Company Funding Arrangements – Host-based Sites](#) for other restrictions that may apply.

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