Guidance on Start-Up Companies and Equity Management

Purpose

Consistent with the University of California, San Francisco's (UCSF) mission of advancing health worldwide is the translation of scientific discoveries into new products and services (commercialization). The creation of new companies (start-ups) to facilitate commercialization has proven to be an effective strategy to bring these advances in healthcare to the community. UCSF licenses intellectual property rights to these start-ups, and in most cases, the start-up provides equity (company shares or options to acquire shares) to UCSF as partial consideration for these rights.

UCSF is supportive of its inventors and authors who seek to commercialize their inventions through the creation of start-up companies. However, there are state laws, as well as system wide (University of California) and campus policies within which all UCSF employees must operate. This guidance document aims to synthesis these requirements into one document to inform our entrepreneurial community.

Guidance:

1) UCSF employees must report their Inventions

a. UCSF employees must promptly report and fully disclose their Inventions to Innovation Ventures via the Inventor Portal. This disclosure must occur *before* any public disclosure to persons outside of the University of California system.

  i. Similarly, non-UCSF employees who signed the UC Patent Acknowledgement must also report their Inventions.

b. Whether an Invention was the outcome of an employee fulfilling their contractual duties to UCSF, or whether the Invention was the outcome of outside consulting activities performed by the UCSF employee for another entity, all Inventions must be reported so that title (ownership) and obligations may be determined. Please refer to the University of California Patent Policy.

c. UCSF employees involved in the creation of a Start-Up which utilizes UCSF Intellectual Property must ensure that the Start-Up obtains the legal rights to use this Intellectual Property. These intellectual property rights can take the form of know-how rights, tangible property rights, data use rights, registered or unregistered copyrights, or patent rights.

d. Non-compliance with this section (1) may result in a range of consequences including the faculty members Category I approval request to be a Founder/co-Founder being denied or rescinded (Refer to section 3.d).

2) Inventor involvement in negotiating a license to UCSF Intellectual Property

Inventors and authors play an essential role in working with UCSF to commercialize their Inventions. This role includes assisting UCSF to market the technology to prospective licensees. However, the disqualification requirements of the California Political Reform Act (CPRA) and UCSF policy require an inventor who has a disqualifying personal financial interest in a university licensing decision to refrain from participating in or influencing the decision. Therefore, an inventor/author who seeks to license UCSF Intellectual Property into a Start-Up in which they hold Equity, the right to invest, or reasonably expect to receive Equity in the future, must refrain from influencing license negotiations by taking the following actions:

a. Nominating a representative of the Start-Up to negotiate on behalf of the Start-Up. This representative must be either an employee, director, shareholder, or have contractual rights to invest (e.g., SAFE note holder) in the Start-Up. A Start-Up without these personnel is rarely able to demonstrate satisfactory business planning to obtain a license. Further, the inventor can benefit from the additional business acumen offered by these personnel.

   The Start-Up representative must *not*:

   i. be concurrently employed or compensated by UCSF.

   ii. have been employed by UCSF within the last year. The CPRA bans former state employees from influencing licensing decisions one year post employment.

   iii. have participated in or influenced the license negotiations as a UCSF employee. The CPRA permanently bans switching sides in a transaction.

   iv. be an attorney or consultant. An attorney or consultant taking instruction from an Inventor (their client) does not remove the conflict of interest. Attorneys and consultants may participate, but a Start-Up representative must be available to instruct them.

b. Not discussing financial terms of the license with the nominated Start-Up representative or UCSF.

c. Cooperating with UCSF by answering questions, as well as providing data and materials, in a complete and timely manner irrespective of which prospective licensee has been selected by UCSF for marketing, due diligence or licensing.

d. Non-compliance with this section (2) may result in a range of consequences including the faculty members Category I approval request to be a Founder/co-Founder being denied or rescinded (Refer to section 3.d).

3) **Start-Up roles**

   a. APM671 and APM25 are the University of California policies on conflict of commitment and outside activities of faculty members. Most UCSF faculty are subject to one of these policies. While this section (3) summarizes some key requirements of these policies, faculty members should familiarize themselves with these policies before participating in a Start-Up company or accepting Equity. For additional guidance, please contact your Dean's Office. University of

California policies APM-671, APM-25 as well as APM-670 (the Health Sciences Compensation Plan) are the dominant policies where any conflict exists with this guidance on Start-Up Companies and Equity Management.

b. UCSF faculty are permitted to serve on a **scientific advisory board**, perform **consulting** activities for, or be a company **director** of, an outside company without prior approval but must fulfill disclosure requirements as part of annual reporting (Category II activities). Further, there are time and income thresholds applicable under APM671 and APM25 which may limit or prevent UCSF faculty from performing these roles.

   i. Should a UCSF employee accept a directorship, they must *not* vote on, participate in, or influence, matters that relate to licensing UCSF Intellectual Property as doing so would conflict with the CPRA and this guidance.

c. UCSF faculty must *not* commence employment nor commence a managerial or executive role with a company until they have obtained prior approval from the Chancellor (Category I activity). Such approval is obtained through OATS. Category I approvals for employment, as well as managerial and executive roles are generally limited to one year in duration.

d. UCSF faculty must *not* participate as a Founder or co-Founder in a company until they have obtained prior approval from the Chancellor (Category I activity). Such approval is requested through OATS and requires renewal annually (see section 6).

e. UCSF faculty may apply for a leave of absence without pay to pursue entrepreneurship or innovation activities. Under APM759, the Chancellor has the authority to grant leave without pay for up to one year. Such leave may be renewed in increments of one year or less (but not indefinitely). In general, leave without pay will be considered when the request involves work at a Start-Up that is licensing and commercializing UCSF Intellectual Property and the activities performed while on leave are expected to enhance a faculty member's contributions to UCSF. Please refer to the Office of Faculty and Academic Affairs for additional information.

4) **Receiving Equity**

a. There are three scenarios in which a UCSF employee may receive Equity, or the right to acquire Equity (e.g., options or warrants):

   i. **UCSF negotiates Equity as consideration for a license to UCSF Intellectual Property.** Inventors and authors who are UCSF employees will receive either 35% of the Equity negotiated by UCSF (per section 4.b.i), or 35% of the net cash proceeds from the sale of Equity (per section 5a). Per the University of California Patent Policy, where there are multiple inventors, the consideration received will be divided among those who are UCSF employees.

   ii. **Directly from a company in which they are a Founder/co-Founder.** UCSF employees are generally permitted to hold Equity. For faculty members, Category I approval *must* be obtained *prior* to founding the company. In addition to Equity received directly from the company, UCSF employees also receive a share of UCSF negotiated Equity (see section 4.a.i, above) where applicable. Faculty are required to disclose all non-cash compensation, including Equity or options, within 30 days of receipt to their Dean's Office.

iii. **As consideration for consulting services**. UCSF employees are generally eligible to accept Equity as consideration for consulting services. Such an arrangement will be between the UCSF employee and the company. For faculty members, this is subject to the requirements of Category II approval. Faculty are required to disclose all non-cash compensation, including Equity or options, within 30 days of receipt to their Dean's Office.

Note: where the Start-Up issuing Equity or options intends to commercialize UCSF Intellectual Property, the faculty member will be considered a Founder or co-Founder and *not* a consultant being remunerated with stock or options. Therefore, all UCSF employees who are consulting to a Start Up commercializing UCSF Intellectual Property must seek Category 1 approval to be a Founder (refer to section 3.d).

b. Where UCSF receives Equity as consideration for the licensing of UCSF Intellectual Property (refer section 4.a.i), UCSF will hold the inventor's/author's share of Equity on their behalf.

i. If, however, a licensee Start-Up subsequently lists on a public stock exchange or public market, UCSF will request the licensee to affect the subsequent transfer of Equity it holds on behalf of the inventors/authors to the applicable inventors/authors. Upon such transfer, employees become responsible for seeking independent tax and legal advice. Should the licensee not agree to such subsequent transfer upon a public listing, or should an employee decline to hold shares directly, UCSF will continue to hold this Equity on behalf of the employee.

c. UCSF may accept a controlling Equity interest in a non-operational Start-Up, provided that prior approval from the Chancellor is received in each instance. Non-operational Start-Ups are those companies which are registered but have never traded or conducted business, nor hold any assets or liabilities. UCSF is generally expected to hold a non-controlling Equity interest upon the Start-Up becoming operational.

5) **Sale of Equity held by UCSF**

a. If Equity held by UCSF is converted to cash (liquidity event) in whole or in part, through a merger, acquisition, dissolution, sale of Equity by UCSF (section 5.c) or other transaction, the net cash proceeds will be distributed in accordance with any applicable inter-institutional agreements or other revenue sharing agreements, and in accordance with either the University of California Patent Policy which states 35% of net income will be distributed to those inventors who are UCSF employees, or distributed in accordance with UCSF's Copyright Income Distribution policy.

b. Approximately half of all exit events for UCSF Start-Ups occur through being acquired by another company. In this scenario, UCSF has no influence over the timing of the sale of this

Equity. In contrast to this, for the other half of exits that occur through listing on a public stock exchange or market, UCSF will sell this Equity in accordance with the below selling schedule (5.c).

c. The sale of Equity held by UCSF will occur in 10 equal installments approximately every 6-months until all shares are sold, with the first sale occurring at the first available opportunity (usually 180 days after the initial public offering when the lock up period expires). This typically results in UCSF liquidating its entire position within 5.5 years from the date of public listing.

6) **Approval to be a Founder must be renewed annually:** Faculty must seek prior approval from the Chancellor before accepting a role as a Founder or co-Founder. This approval must be renewed annually. The committee will consider each request for renewal on a case-by-case basis, with factors including the status of a license between the Founder's Start-Up and UCSF (if applicable) being considered. Inventors/authors often receive Equity directly from a Start-Up in exchange for the UCSF Intellectual Property they create. Rights to UCSF Intellectual Property must be legally obtained by the UCSF employee's Start-Up company through a license, where applicable. Further, UCSF employees have a continuing obligation to disclose new Inventions in accordance with section 1 of this guidance.

7) **Valuing UCSF Intellectual Property**: UCSF has an obligation to obtain fair market value when licensing intellectual property. While databases containing comparable licensing transactions are often cited by prospective licensee companies, these databases include transactions from institutions who are not required to achieve fair market value or have arranged to receive consideration in ways not captured in the license. Given this, UCSF shall provide significant weighting to comparable transactions from UCSF, as well as current market dynamics specific to the technology, when valuing UCSF Intellectual Property.

8) **Preventing the pipelining of intellectual property**: UCSF has an obligation to make its Inventions available to those best able to commercialize them. This requires UCSF to prevent the practice of default licensing of future Inventions to a Start-Up in which UCSF holds an Equity interest (often referred to as pipelining of technologies). Given this, where UCSF already holds Equity in a licensee Start-Up, and that licensee wishes to negotiate a license for UCSF Intellectual Property unrelated to the original license, UCSF must approach multiple potential licensees before committing to a license.

9) **Clinical trials**: UCSF must not undertake clinical trials for companies in which it holds Equity, unless prior approval has been received from the Conflict of Interest Advisory Committee. Requests to verify UCSF equity holdings can be made by UCSF employees to Innovation Ventures at innovation@ucsf.edu.

10) **Equity from non-University IP:** UCSF has partnerships with research organizations which may occasionaly result in UCSF receiving Equity as part of a license for intellectual property in which UCSF does not have title (ownership). UCSF may accept this Equity. The absence of

inventors/authors to distribute income to means the income distribution provisions of the UC Patent Policy and the relevant equity distribution provisions of this guidance are not applicable. The distribution of income generated by this non-UCSF Intellectual Property will be divided between the campus and the Office of Technology Management and Advancement at a ratio to be determined by the Chancellor.

11) **Directorships and voting rights for UCSF:** UCSF shall neither seek nor accept representation on the board of directors of a licensee company in which it holds Equity, nor exercise any voting rights, regardless of the level of its Equity interest, unless UCSF is required to appoint a temporary director to a UCSF majority owned, non-operational company, per section 4.c. UCSF may accept board observer rights.

12) **Guidance principles:** UCSF acceptance of Equity in consideration of licensing UCSF Intellectual Property shall be based upon the principles of openness, objectivity and fairness in decision-making, and preeminence of the education, research, and public service missions of UCSF over financial or individual personal gain. Such licensing activity shall be conducted in accordance with the University Guidelines on University-Industry Relations, the Conflict-of-Interest and Conflict of Commitment Policy, the University Policy on Integrity in Research, and related University policies and guidelines.

13) This guidance begins on the Effective Date. All sections of this guidance will apply retrospectively, except for sections 4c and 5c.

DEFINITIONS:

Equity: stock or any other instrument conveying ownership in a company or asset, typically expressed as a percentage of ownership.

Start-Up: for the purposes of this guidance, means a legal entity created for the purpose of developing and/or commercializing Intellectual Property.

Founder: means a UCSF employee who accepts or intends to receive Equity (or the right to acquire Equity through a financial instrument including, but not limited to, a SAFE note or Warrant) in a Start-Up.

Invention: Includes a unique or novel device, method, composition, process, machine, manufacture, design, or composition of matter, or any new and useful improvements, or any variety of plant, which is or may be patentable under United States patent laws and regulations, or protectable under an analogous intellectual property right.

Intellectual Property: includes all Inventions, discoveries, developments, systems, methods, and materials, as well as all software and other copyrightable works for which the University of California retains copyright ownership under the Copyright Ownership Policy or Ownership of Course Materials Policy. Includes legally recognized rights in patents, registered or unregistered copyrights, registered or unregistered trademarks, service marks, and plant variety protection certificates. It also includes the physical embodiments of intellectual effort, for example, models, organisms, machines, devices, designs, apparatus, instrumentation, circuits, biological materials, chemicals, other compositions of matter, and plants. Future advances in science and the arts may result in new structures for intellectual property protection and they also fall within this policy definition.

This guidance specifically excludes (1) scholarly and aesthetic works for which the copyright transfers to academic authors under the Copyright Ownership Policy and (2) student works for which the copyright resides with the student creator under the Copyright Ownership Policy.

UCSF Intellectual Property means all Intellectual Property wholly or partially created:

1) Within the course or scope of UCSF employment, and/or;
2) Using UCSF Research Facilities, and/or;
3) Using gifts, grants, or contracts received by or through UCSF.