



Harvard University
Procedures for Acceptance, Management and Sale
of License-Derived Stock

Approved by the Committee on Patents and Copyrights January 17, 1997. These Procedures implement the May 1, 1995 vote of the President and Fellows of Harvard College approving the acceptance of license-derived stock.

Guidelines for equity received as part of a licensing arrangement

1. Harvard's equity position should be a minority one (generally less than 15%) -- and that position may be diluted as the company raises additional capital.
2. Harvard as an institution should not hold Board positions.
3. In the event individual inventors hold (or will hold) stock in the company, the requirements of the Conflict of Interest in Licensing policy shall be followed.
4. Harvard should not invest in the formation of the company. This does not preclude investments by venture capital funds in which the Harvard Management Company has invested or by Medical Science Partners since investment decisions by these organizations are made at "arms length" from Harvard.
5. The equity will be held in a separate account by the Harvard Management Company and will be managed and sold according to procedures which insure that decisions to sell are made at arms length from the Faculty or administrative unit which originated the licensed technology. The Harvard Management Company will also follow its existing procedures dealing with such issues as conflict of interest and insider trading, etc.
6. Stock will be sold in an orderly fashion as soon as it is possible to sell it in the public market (i.e., once it is publicly traded and any "lock-out" period has expired).
7. Harvard should not invest directly in later rounds of private financing for the company unless the investment is part of the Harvard Management Company's normal investment activities and decisions are made by personnel insulated from the management of the license-derived stock.

Approval process for accepting equity

All such arrangements must have the approval of the Chairman of the Committee on Patents and Copyrights. That approval is for the purpose of ensuring that the above criteria have been met. As a general rule the acquisition of stock as part of a license arrangement will be reviewed with the full Committee on Patents and Copyrights well in advance. If a proposed arrangement does not meet any of the preceding criteria, it will be carefully reviewed for appropriateness by the Committee on Patents and Copyrights and, if deemed necessary, submitted to the Vice Presidents and Provost for approval.

Discussion and Explanation

Why does Harvard accept equity? The basis for accepting equity in licensee companies is a financial one -- it serves as added compensation when the licensee company (generally a start-up) has limited cash available. Because a start-up company's survival is tied to the development of the licensed technology, its R & D effort is focused on that technology. As a result, a start-up company can represent the best opportunity for the development of early-stage technology. In fact, in some cases, a start-up may be the only avenue available.

Of the 50 plus licenses and options granted each year, we anticipate that fewer than five would include equity. Typically the companies involved are either just being formed (usually around the technology to be licensed) or are within one or two years of formation. They have little cash and no revenues. Under these circumstances, imposing a heavy cash burden would diminish the company's ability to attract initial investors and would pull critical cash from the research and development efforts that are required to meet Harvard's due diligence milestones and which will allow the company to secure additional financing. Nevertheless, licenses with equity generally do include cash payments such as: (1) up-front license fees, (2) minimum annual and/or milestone payments, (3) royalties on sales, and (4) a percentage of sublicense income.

Stock is not taken in preference to cash; rather, in the absence of sufficient cash compensation and where we believe we have negotiated the best cash terms possible, stock is taken as added compensation. The stock is viewed as a reasonable business solution to enhance the overall financial package -- acceptable to the company and its investors, while providing an opportunity for the University to increase its potential return.

In addition, particularly with technologies that will be the basis for a start-up company, stock provides the University some compensation for the value added to the company as a result of its access to the core technology. In the case of start-ups, the value of the license is based as much on its ability to generate investment capital as on the profits the company may realize from the eventual sale of products utilizing the licensed technology.

Management and sale of equity: At the time the Chairman of the Committee of Patents and Copyrights approves the acceptance of equity as part of a license arrangement, the Office for Technology and Trademark Licensing/HMS Office for Technology Licensing

and Industry-Sponsored Research (OTTL/OTL) will specify when the equity will be liquidated: the initial public offering (IPO); the earliest date after the IPO that the stock agreement allows; when the company is acquired and its stock is converted into stock in a publicly traded company; when a product has reached a specified stage in the regulatory approval process; or when a product first comes onto the market.

When the equity is received, it will be turned over to the Harvard Management Company (HMC) for management, and HMC will be informed of the event that will trigger sale of the stock. HMC will hold all license-derived stock in a separate account. Once the trigger event occurs, HMC will proceed to sell the stock.

After discussions with HMC, with external management groups and with members of the Harvard Business School faculty, the Committee on Patents and Copyrights decided that the University would not hold license-derived stock after it could be liquidated in an effort to time the sale to increase revenue, rather the University would convert the stock to cash as soon as that is possible. For one reason, prompt liquidation at a predetermined time removes the potential for a public perception of conflict of interest. Secondly, the University did not want to assume an implied obligation to its inventors, departments and schools to maximize the cash return from such stock sales. The use of an external portfolio management group was considered but was rejected since the likely increase in return did not justify the cost.

Distribution of proceeds from sale of stock: When the stock is sold, the proceeds of the sale will be transferred to OTTL's income account for distribution according to the University's royalty sharing policy.