



320 STEPHENS HALL
UNIVERSITY OF CALIFORNIA

May 22, 2015

MARY GILLY
Chair, Academic Council

Subject: Guidelines on accepting and managing equity in return for access to university facilities and/or services

Dear Mary,

On April 27, 2015, the Division Council (DIVCO) of the Berkeley Division discussed the draft guidelines on accepting and managing equity in return for access to university facilities and/or services, informed by commentary from our divisional committees on Academic Planning and Resource Allocation (CAPRA), and Research (COR). Our discussion underscored the specific concerns presented in the committee reports, which are appended here in their entirety.

DIVCO applauds the Office of the President for taking the initiative to develop these guidelines to facilitate acceptance of equity, or equity-like positions, for access to university facilities and services. However, we found that the document lacks sufficient clarity and context to guide decision-making in an increasingly important arena. In addition, DIVCO raised serious concerns about the role of the Office of the Chief Investment Officer. These are well described in point three of the CAPRA report.

While we believe the document represents a useful starting point, the consensus on DIVCO and the reporting committees is that campus-specific guidelines will better meet the needs of Berkeley faculty. Accordingly, we urge the Office of the President to develop a general framework (rather than a heavily prescriptive set) of guidelines that all campuses can adopt and use as a common basis from which to meet their local needs.

Sincerely,

A handwritten signature in black ink that reads "P Papadopoulos". The signature is written in a cursive, slightly slanted style.

Panos Papadopoulos
Chair, Berkeley Division of the Academic Senate
Chancellor's Professor of Mechanical Engineering

Encls. (2)

Cc: Nancy Wallace, Chair, Committee on Academic Planning and Resource Allocation
Robert Powell, Chair, Committee on Research
Diane Sprouse, Senate Analyst, committees on Academic Planning and Resource Allocation, and Research

April 22, 2015

**TO: PANOS PAPADOPOULOS, CHAIR
BERKELEY DIVISION OF THE ACADEMIC SENATE**
**SUBJECT: CAPRA Review of the *Guidelines on Accepting and Managing
Equity in Return for Access to University Facilities and/or Services***

Overall Assessment:

CAPRA is generally very supportive of the pilot program guidelines on the contractual mechanisms by which the University of California (UC) could accept equity in non-university incubators or accelerators as an element of the financial consideration for access to space and business support services for such entities. We find the guidelines to be a useful roadmap for individual UC campuses to develop new programs or to modify existing programs to take advantage of this pilot. Fostering incubator or accelerator projects on the part of UC faculty and students has the potential to greatly enhance departments' and laboratories' research funding and may be a great investment for all participants. CAPRA further believes that these guidelines should serve as a starting point for the development of stand-alone UC Berkeley guidelines that are more closely aligned with the specific needs of our campus.

CAPRA identifies the following specific concerns with the guidelines:

1) CAPRA is concerned about the limitations on faculty board representation and voting in authorized incubators and accelerators as outlined on page 9:

“D. Board Representation/Voting Rights

Employees of the University, acting in their capacity as University employees, shall not accept a position on the board of directors in a Company in which the University has an Equity interest pursuant to this program, nor shall they exercise related voting rights, but may accept and exercise observer rights on such boards. Active board participation and/or the exercise of voting rights by an individual in his or her capacity as a University employee might expose the University to unacceptably large management, conflict of interest, and public relations problems. A University employee who is an inventor of intellectual and tangible property licensed by the University to a Company may participate on the scientific advisory board of that Company, but only if such boards do not have delegated voting authority to act independently on behalf of the full board of directors.”

CAPRA believes that blocking faculty members from board-level decisions if the UC takes ANY equity via this program is onerous. This provision suggests that if equity is transferred, even if the UC equity position that is transferred to obtain incubator access is small, the faculty member can no longer directly guide the company. Our concern is that, as written, this provision will induce faculty to leave the university so that they can stay involved with their own companies. Additionally, CAPRA notes that this requirement is inconsistent with current licensing policies, whereby a UC equity position that is part of a licensing agreement does not necessarily ban board membership. Therefore, CAPRA recommends that this provision should be changed to some reasonable trigger, for example, if UC owns more than 5% of equity via this program, after which UC will

constrain a faculty member's future managerial involvement in an incubator project as a means to align incentives.

2) CAPRA is concerned about the latitude given for running clinical trials by a Principal Investigator in UC space as outlined on page 9:

"F. Company-Sponsored Product Testing

A University investigator may perform clinical trials or other comparable product-testing involving human subjects for Companies in which the University holds Equity as part of an AFS transaction on the campus/Laboratory where that technology arose provided that the campus conflict of interest committee has assessed any real or perceived organizational conflict of interest in the performance of such trials or testing activities and determined Page 9 of 36 whether a management plan is required, and the relevant IRB has reviewed and approved the protocol."

The basis for this concern is the potential for conflicts of interest between the incentives of a faculty member who is running a clinical trial in UC space and the incentives when the faculty member is also an equity owner, corporate officer, and/or inventor of the technology. The experience at Berkeley has been that the Internal Review Boards (IRBs) and the Conflicts of Interest (COIs) Committees are in some cases not sufficiently knowledgeable about the merits of the technology and the extent of the conflicts of interest to adequately manage this issue. For this reason, CAPRA recommends that clearer guidelines, such as requiring an impartial third party to oversee clinical trials, should be established rather than relying on IRBs and COIs to manage potential conflicts and/or to assure that equity interests do not distort the performance and reporting of trials. As a matter of principle, it seems unwise to have the founder also serving as the sole investigator running a clinical trial.

3) CAPRA notes that the envisioned role of the Office of the Chief Investment Officer (CIO) as defined on page 14 is quite strong and is somewhat unusual by industry standards. In particular, CAPRA is concerned that this provision

"3. Any decision made by the CIO to purchase additional shares of Equity in a Company in which the University has accepted Equity as part of an AFS transaction should be evaluated in terms of the financial return to the University. Such subsequent investments should be considered and maintained separately from the original AFS-related arrangement and the resulting proceeds from such subsequent investments shall not be considered for distribution under the University Equity Policy."

is overly prohibitive because it appears to limit the original AFS (as defined on page 3, as the "...access to University facilities and/or services ("AFS") in the context of University incubators or Accelerators...") to an equity participation in the initial round of funding ONLY. CAPRA recommends that the AFS be allowed to retain the option to participate in subsequent rounds of funding, perhaps along with the CIO. Participation of the AFS in subsequent rounds will avoid dilution of the AFS's original position (however, it is important to note that for the AFS to exercise its right of participation in future rounds, it will be required to invest additional capital).

4) CAPRA also highlights concerns with provisions presented on page 15:

3. The Campus or Laboratory's subsequent use and distribution of its portion of any cash proceeds shall be handled in accordance with the schedules, formulas, and practices established by the Campus or Laboratory, and other applicable policies."

Here CAPRA strongly believes that there should be clear language related to reasonable sharing mechanisms of these cash distributions. The concern is that leaving poorly defined distribution rules may weaken the crucial role incubator proceeds should have in sustaining and enhancing departmental and laboratory on-going research productivity. CAPRA believes that it is critical to establish more clarity concerning the sharing rules of cash proceeds to the campus administration, to the incubator, and to the department and/or laboratory that initially seeded the research activity.

5) CAPRA has reservations concerning the University's stated preference for stock rather than warrants as the equity that will be accepted in exchange for incubators and/or accelerators access to university space and business support services. This provision appears on page 7.

2. The University's preference is to take Equity in the form of Stock, Units or similar securities that are fully paid for rather than Warrants or options which are a right to later purchase securities of a company at a predetermined price. Acceptance of options or Warrants may be approved on a case-specific basis by exception. At a minimum, approval for such exception will require that 1) private funding (e.g., not state funding) is available and reserved to provide cash needed to exercise such options or Warrants and 2) the options or Warrants comprise a minority portion of total financial consideration. In addition, prior arrangements would need to be made by the campus to manage the rights and interests of all involved parties in such options or Warrants.

Again, this preference is somewhat contrary to industry practice where, for example, warrants are commonly accepted in place of, or as a component of, rent. Firms often prefer to grant warrants, because they are only valuable if the firm ends up being successful. CAPRA therefore suggests that this preference for non-warrant equity be weakened or eliminated. The concern about having funding for exercise is unnecessary as long as the warrants are exercised cashlessly (i.e., a portion of the exercise proceeds is used to pay the exercise price). However, we agree that it makes sense for such warrants to be a small part of total financial consideration.

April 15, 2015

TO: PANOS PAPADOPOULOS, CHAIR
BERKELEY DIVISION OF THE ACADEMIC SENATE

Re: COR Comments on draft guidelines for pilot program to accept equity for access to university facilities or services

The Committee on Research (COR) discussed the draft guidelines for a pilot program to accept equity for access to university facilities or services at its 30 March 2015 meeting and has several comments.

1) Most broadly, the issue of accepting equity in return for access to university facilities or services would seem to be only one of several aspects of the nascent relationship between the university and entrepreneurs. Other aspects include intellectual property and licensing to mention two. Taking an integrated approach to dealing these issues as a whole rather than in a piecemeal fashion might increase the chances of creating a structure in which these entrepreneurial relationships would develop fruitfully.

2) There is some concern that provision “D,” *Board Representation and Voting Rights* (pg. 9), is too restrictive. This provision would preclude employees accepting a position on the board of directors or exercising any voting rights. One member of the committee said that this provision would be the decisive factor in preventing him or her from entering into a shared-equity relationship with the university. Avoiding conflicts of interests is, of course, crucial. But perhaps there is some way to do so with a less restrictive provision.

3) Provision C.1 states:

University acceptance of Equity for AFS shall be based upon the educational, research, and public service missions of the University over financial or individual personal gain.

This is a worthy principle, but it is much less clear what it means in practice? Taking equity in what kinds of companies would be consistent and inconsistent with this? APM 25-10.c provides examples of category I, II, and III activities. Some concrete examples of what would and would not be consistent with this provision would be useful in guiding future determinations in this regard.

4) Provision C.2 reads:

The support of new businesses affiliated with the University is in the public interest and furthers the University’s training and educational objectives. Further, University engagement with new businesses is appropriate and represents a useful contribution because the University’s engagement with industry is consistent with the University’s mission.

The first sentence could be construed as asserting that any affiliation is in the public interest. It should be revised along the following lines:

The support of new businesses affiliated with the University *shall* be in the public interest and further the University’s training and educational objectives.