

**UNICO PRACTICAL GUIDES**  
Commercialisation Agreements

---

7

## spin-out transactions



# Foreword

Over recent years, the Knowledge Commercialisation profession has grown and matured, creating a huge wealth of knowledge, experience and best practice relating to University commercialisation contracts. The UNICO Practical Guides have been produced specifically to share this knowledge, experience and best practice within the profession.

The UNICO Practical Guides are practical guidebooks on University Contracts. They are designed primarily for use by people in the profession, both new and experienced, in order to tap into the collective learning of colleagues and peers.

The Practical Guides have been produced as a resource for Knowledge Commercialisation professionals in the UK. They are not designed to replace or compete with existing manuals or guides, but to provide a new and, we believe, vitally important set of support materials to those of us in the UK who deal with University commercialisation contracts on a daily basis.

We hope that you find the UNICO Practical Guides useful.

**Neil Bradshaw,**

University of Bristol

Chair, UNICO

The UNICO Practical Guides were prepared by UNICO in association with Anderson & Company, The Technology Law Practice™

# Contents

## Chapter

1	General Introduction	5
2	Introduction to Spin-out Transactions	7
3	Summary of Best Practice	23
4	Key Negotiating Issues in Spin-out Agreements	27
5	A Checklist of Common Provisions found in Spin-out Agreements	45
6	Administration of Spin-out Agreements	51

## Appendix

A	Templates	56
	1. Term sheet	57
	2. Shareholders agreement	61
	3. Articles of Association	96
B	Notes on completing the templates	118
C	In-depth discussion of commercial issues in Spin-out Transactions	119
D	Special legal issues for Spin-out Transactions	128

# Chapter 1

## General Introduction

In recent years, UK universities have become more active in forming spin-out companies as a method of commercialising intellectual property – sometimes too active, suggested the Lambert Review of University-Business Collaboration (2003). Some have been very successful, in the 30 months to the publication of this edition of this guide 21 University spin-outs had floated on public markets, collectively being valued at more than £1billion and raising more than £250million in funds.

In a typical transaction, the spin-out company acquires a package of intellectual property from the university. The university and lead academic(s) are shareholders in the company. At some point an investor provides funding to the company in return for further shares. The company is responsible for further development and commercialisation of the intellectual property.

**The purpose of this Practical Guide is three fold:**

- 1 to provide an introduction to spin-out transactions and the terms of spin-out agreements, including discussion of legal, practical and negotiating issues;
- 2 to provide some suggested templates together with guidelines concerning their completion; and
- 3 to consider and discuss some underlying issues which are problematic or of particular concern for universities.

This Practical Guide attempts to provide information that is useful for both the beginner and the more experienced research contracts or technology transfer professional. The breadth of material covered may give the misleading impression that university contracts are fraught with legal and commercial difficulties. Usually, this is not the case. But sometimes differences of expectation, practice or legal culture can arise between the parties negotiating an agreement. In the case of spin-out transactions, there tends to be a large set of agreements that needs to be considered. The beginner may wish to focus on the earlier chapters and to use the detailed discussion that appears in later

chapters as a reference source if a specific question or problem arises.

In addition to this Practical Guide, users can also access a password-protected page on the UNICO web site at [www.unico.org.uk](http://www.unico.org.uk) which (now or in the future) will contain:

- (a) an electronic copy of this Practical Guide
- (b) additional material as it becomes available, which may include additional precedent material and updates to the Practical Guides; and
- (c) an email discussion forum, where UNICO members can exchange information, ask questions, etc on issues concerning the subject matter of these Guides.

# Chapter 2

## Introduction to Spin-out Transactions

### Introduction to spin-out companies and agreements

#### What is a spin-out company?

The term *spin-out* refers to the fact that the university's intellectual property (IP) is 'spun out' from an academic environment into the commercial arena. The term *spin-out* company is a convenient label for a company that, typically:

- is incorporated by an academic or a university;
- acquires IP from the university with a view to developing and commercialising that IP;
- acquires funding from outside investors, usually in return for shares in the company;
- has several shareholders who (by the time outside investment has been obtained) may include the university, the key academic(s), possibly any senior manager(s), and the investor(s); and
- is (at least in its early days) a small- to medium-sized enterprise whose assets, other than IP, may be limited.

#### Why are spin-out companies formed?

Forming a spin-out company is one of the ways in which an academic or university can arrange for the further development and commercialisation of technology. Other routes to commercialisation include licensing an established company or making the technology freely available, e.g. through scientific publications, in the hope that commercial enterprises will use the technology in commercial products and services. The main choices facing the technology transfer executive (TTE) will often be (1) forming a spin-out company, or (2) licensing to an established company. These choices (which are not mutually-exclusive) are discussed further, below.

## Who forms the spin-out company?

This question arises at both a technical level – who incorporates the company at the Companies Registry – and at a more strategic level, i.e. who is responsible for managing the spin-out process. For tax reasons, many spin-out companies have been incorporated by the lead academic(s), with the university and investors becoming shareholders at a later date. Tax issues are discussed further in Appendix D.

The larger question is the extent to which the university (as well as the lead academics) should be involved in developing the spin-out proposition, finding investors and management for the company, appointing solicitors and negotiating the formation agreements, etc. In other words, should the TTE invest large amounts of efforts in, and be responsible for managing, some or all of the spin-out process, or at the other extreme should his or her role be limited to ensuring that the terms of any agreements do not adversely affect the university's interests?

In the authors' experience, many universities take a relatively 'hands-on' approach in the formation of spin-out companies, and much of the following text assumes that approach. However, a more 'hands-off' approach is taken by some universities, where the inventors have primary responsibility for developing the spin-out proposition and the university's role is more reactive – to support the academic in an advisory capacity (if and when advice is sought), to give permission where needed and to ensure that the terms of the transaction do not expose the university to unnecessary liabilities. The degree of TTE input may depend, partly, on the local business environment in and around the university.

## Typical process for setting up a spin-out company

Setting up and running a spin-out company typically involves a number of stages, which may include the following (not always in this order, and some of these stages may be simultaneous):

- *Start-up*
  - Initial discussions with academics, including initial due diligence on the IP and investigation of possible routes to commercialisation
  - Preparation of a business plan for the company
  - Incorporation of the company

- University approval of a proposal to spin-out IP into the company
- Agreement in principle with the academics, including relative shareholdings
- *Structuring a deal*
  - Finding the investors
  - Agreement in principle with the investors, including amount of investment, relative shareholdings, scope of IP to be put into company, business plan, role of the academics in the company, etc, etc.
- *Detailed negotiations and formalities*
  - Negotiation of detailed agreements between university, academics and investors, including investor protection provisions, warranties, etc.
  - “Completion”, including transfer of IP rights, funding etc into company, appointment of directors, etc.
- *Ongoing management of the company, including*
  - employment of key staff, acquisition of premises, trading
  - further rounds of financing
  - “exit” strategy

### **What types of agreements are signed when a spin-out company is set-up and financed?**

Setting up spin-out companies typically involves the negotiation and preparation of a large number of commercial documents that together can form a ‘bible’ of documents, several inches thick. The bible may include some or all of the following:

- company formation documents
- business plan
- document(s) recording the internal approval of the university to a spin-out opportunity
- agreements over allocation of shares between the university and each academic, etc
- preliminary agreements with investors, e.g. confidentiality agreement, term sheet



- due diligence documents, including questionnaires, disclosure letter
- investment/shareholders agreement
- new memorandum and articles of association
- (sometimes) loan agreements with investors
- assignments of IP from the inventors to the university
- intellectual property agreement (i.e. to license or assign university IP to company)
- other IP agreements, eg option/pipeline agreement, research contract with university
- consultancy agreements with key academics
- employment contracts with key employees
- share option schemes
- property leases, etc.

### Why is there such a complex set of agreements?

Establishing a spin-out company involves a more complex set of agreements and documents than licensing to an established company. The spin-out company is at the centre of a web of relationships – with the university, academics, investors, directors, employees, landlords, insurers and others. Put another way, as well as licensing or assigning IP to the spin-out company, it is usually necessary to prepare/agree documentation in the following areas:

- forming the company and providing it with a constitution, officers, etc
- establishing the corporate relationships
- dealing with the intellectual property assets (which for various reasons, discussed below, is often more complex than when licensing an established company)
- running the company

It is important to separate the various aspects of the transaction into its component part and to treat each as a separate (albeit simultaneous) transaction. There are several reasons for this:

- it simplifies the negotiation by breaking it down into 'bite-sized' parts

- the parties to each agreement may be different and, where the university is a party, different parts of the university may need to be involved (e.g. Estates, Personnel)
- in most cases, each agreement should be capable of standing alone – the licence agreement is likely to outlive all the others
- some of the agreements may need to be publicly disclosed (e.g. under the Freedom of Information Act)

### **Does the TTE need to be an expert in all of these areas?**

The TTE who is project-managing the university's interests in a spin-out company probably needs a general awareness and understanding of most of the above issues, and a more detailed understanding of a smaller set of issues, depending partly on how 'hands-on' the university's approach is to spin-out transactions. A more detailed understanding is probably appropriate for the terms of the corporate relationships and the IP agreements, particularly in the key areas discussed in chapter 4, below. Some of the other areas of detail may be safely left to the university's (or the academics') lawyers. This assumes that the university is instructing lawyers in the spin-out negotiations, as to which see chapter 6.

The TTE should be careful not to give advice to the academics in a personal capacity, and should generally recommend that they seek their own legal advice. See further, chapter 6.

### **Which agreements are discussed in this Practical Guide?**

This Practical Guide will discuss, at least briefly, the full range of agreements mentioned above. In view of the breadth of subject-matter of these agreements, and the limited space available, some topics are covered only in outline. The main focus of this Practical Guide will be on the corporate aspects, including the respective rights and roles of the investors, university, academics and company, and on IP policy issues.

### **Where are licences, options, consultancies and CDAs discussed?**

Spin-out transactions usually include an agreement under which IP is licensed or assigned into the spin-out company. The detailed issues that arise in

licence agreements are discussed in a separate Practical Guide to Licence Agreements. Special issues that arise when assigning, rather than licensing, IP into a spin-out company are discussed below. The detailed terms of confidentiality agreements, consultancies and option agreements (all of which may feature in spin-out transactions) are discussed in other Practical Guides.

## Deciding whether to form a spin-out company

### Spin-out company or traditional licence agreement?

The TTE will wish to consider, on a case-by-case basis, which is the best route to commercialise a package of IP. The role of the academics in this decision-making process will vary from university to university, but in any event they will usually be a good source of information. In many cases, the main alternatives will be (a) licensing the IP to an established company or (b) assigning or licensing the IP into a spin-out company.

These alternatives are not mutually-exclusive – often a university will form a spin-out company in order to raise funds that can be used to add value to a technology prior to the company licensing the technology, in a more developed or validated form, to an established company.

Some universities have the following factors (among others) in mind when deciding whether to form a spin-out or license an established company:

- What opportunities have presented themselves for the particular package of IP? Are there potential, existing licensees for the technology?
- For some, the 'default' route may be a licence to an established company unless there is no natural 'home' for such a licence
- Licensing may not be the best way to reap the value in a product with potential that is at a very early stage of development – it may be better to find ways of 'adding value' prior to licensing or selling the IP (or any business that owns the IP)
- Where a technology has multiple applications (e.g. a 'platform' technology), forming a spin-out company is sometimes seen as a better route for the university than granting numerous non-exclusive licences

- The character, personality and commitment of the lead academic(s) are usually important factors: is he or she suited to being involved in a spin-out company and committed to devoting sufficient time on the spin-out, and (if a full-time commitment if required) does he or she want to move away from an academic career?

For some experienced TTEs, the process is one of instinctively 'feeling' which is the best route, then validating that feeling over a period of time, as the project progresses. At the outset, the commercial strategy should be the same: to talk to a number of companies who 'should' be interested in the technology and to ascertain whether they would be interested in acquiring a licence to the technology. If they are, then this may be the best route. If not, then you may gain valuable intelligence on how a spin-out company might add value to the technology.

This approach should not be confused with 'the line of least resistance', e.g. if there is an eager investor in the wings, and no obvious licensee in sight, it may be tempting to form a spin-out company rather than put time and effort into finding a suitable, established company to be a licensee.

The Lambert Review considered that spin-out companies were sometimes formed by UK universities at too early a stage. Put crudely, such companies were just vehicles for funding research projects rather than genuine business propositions. It is understood that these comments relate to occasional, past practice, and that more recently-formed spin-out companies have tended to be more sustainable as businesses.

Establishing a spin-out company is not a quick and simple process. The academic(s), in particular, must be fully committed, and be willing to devote the necessary time involved. If they are not, the spin-out is unlikely to be successfully established.

### Typical differences in the process of licensing or spinning-out

It may be helpful to make a few broad generalisations about some typical differences between licensing to an established company and the use of a spin-out company.

### Licensing to an established company – long term, specialist technology transfer activities

- It can be difficult and time-consuming finding and generating interest from suitable licensees.
- Licensees tend to be larger companies that can develop, market and sell the licensed product/services. But not in all cases.
- A licence agreement sets up a long-term relationship between the university and licensee that will require managing by the university's technology transfer specialists over the long term.
- The effective negotiation of licence agreements requires an understanding of some rather technical issues. Negotiations can be time-consuming and protracted.

### Spin-out companies – shorter term, 'investment' role

- It is sometimes easier to find investors for spin-out companies than traditional licensees. This depends partly on the investment climate at the time.
- Spin-out companies tend to be small companies that will develop the technology further but may not have, nor expect to have, in-house marketing and sales capability.
- University involvement in a spin-out company tends to reduce over time, as its shareholding is diluted. Many universities assign the relevant IP to the spin-out company (either immediately or once the company reaches a defined stage in its development). Usually, the university does not retain much/any control over, or responsibility for, the commercialisation of the IP once it has been assigned. Consequently, the spin-out company route may require less ongoing management by the university and a different set of skills to traditional licensing.
- Standard issues tend to come up in negotiations over investment. Many of these (e.g. percentage shareholdings, control mechanisms, limits of liability, rights of investors, etc) are more readily understandable than some of the technical issues that occur in licence negotiations. Some universities have gained enough experience to develop clear policies on what they are willing to accept. Negotiations over these issues can be protracted.

- If the spin-out transaction involves a detailed IP licence, some of the same issues discussed in the previous set of bullet points will also arise.

Of course, many licensing and spin-out transactions do not fit within the above framework. For example, the authors have been involved in licensing transactions where the established licensee is a small company that intends to develop the technology further before sub-licensing it to a larger company.

### **Internal approval of the spin-out proposition**

Usually, the university will have a process for approving any proposal to form a spin-out company. This may involve an individual (e.g. a Head of School) and/or a university committee. The stage at which this occurs seems to vary from university to university. Some universities deal with this aspect once the company has been formed and a business plan developed; others give outline approval at an earlier stage.

Sometimes, as part of the approval process, the responsible TTE will prepare a summary of the key terms (as then known) of the proposed spin-out transaction, including relative shareholdings of the university and academics, scope of IP to be transferred to the spin-out company, etc. Some universities require sight of a business plan as part of this process.

It is important to involve other divisions of the university (e.g. Estates, HR, Contract Research) so that they are aware of and comfortable with those aspects of the deal for which they have responsibilities. Securing approvals at the last minute can delay, or even stall, the deal.

At an early stage, a decision may be taken on whether to use any sources of funding that are available to the university, to help the company in its early stages, e.g. 'proof of concept' funds, university challenge funds, etc.

## **Formation of the company**

### **Tax-efficient company formation**

At an early stage in the spin-out process, the spin-out company will be incorporated. There are various types of company that can be incorporated in the United Kingdom, including both public and private companies 'limited by shares'

(i.e. having shareholders), and companies 'limited by guarantee' (i.e. having guarantors rather than shareholders, more usually known as members; this is a popular route for charities that wish to incorporate). Typically, a spin-out company will be a private company limited by shares.

The issue of shares in a spin-out company to an academic inventor creates complex tax issues for the academic. Tax issues are discussed further in Appendix D. At this stage, it is worth mentioning that it has become conventional, for tax reasons, for the spin-out company to be formed by the academic at his own expense and without the involvement of the university. Initially, the academic is the sole shareholder. At a later point, the university and the investor(s) subscribe for shares, at the same time that any intellectual property is licensed or assigned into the company and the investors provide their funding.

Tax issues also drive the terms of the spin-out agreements, the equity structure, and the allocation of shares, which will be discussed later in this Practical Guide.

### Initial constitution

The constitution of a company consists of two documents:

- Memorandum of Association
- Articles of Association

These names are sometimes abbreviated to 'Mem & Arts'. As a rough guide, the Memorandum describes the nature of the company – its objects, powers, capitalisation – whilst the Articles set out rules on how the company will operate – meetings, decision-making, issue and transfer of shares, etc.

TTEs will typically be interested in some of the detail of the Articles of Association. The Memorandum is less likely to be of interest. The Articles include provisions on important topics such as the issue and transfer of shares, the rights of shareholders, the appointment and powers of directors, etc. Obviously these are matters of concern to the university as a shareholder in the company. There is sometimes an overlap between matters covered in the Articles and matters covered in any shareholders agreement that the shareholders may enter into. This is discussed further, below.

## Business plan

A draft business plan will typically evolve in the course of discussions, and may not be finalised until shortly before any external investment is made. Some universities take the view that they will not even consider whether to approve the spin-out proposition until they have seen a proper business plan.

## Reaching agreement in principle

### Are the investors' and the university's interests aligned?

At an early stage in the negotiations, the university should try to establish, through discussion with the investors and other due diligence, whether the investors' objectives for the spin-out company are aligned with those of the university and the lead academic(s). For example, are the investors' required timescales for 'exit' from the company consistent with the anticipated funding requirements of the company? Do they understand the technology and how it is likely to be commercialised? Aspects of the investors' general approach may be gleaned from the draft agreements that they present, for example in the areas of warranties, preferential rights, etc.

### Due diligence and presenting a clean IP package

The investors will usually wish to do extensive 'due diligence' investigations on both the intellectual property and the business proposition. As part of this process, they will ask detailed questions of the university concerning such matters as who created the IP, the terms of any research contracts or other obligations (e.g. grant conditions) affecting that IP, whether any third party infringements are known to it, etc. They will also ask the university to give warranties about the state of the IP, against which the university may make disclosures of any problems or issues known to it.

The extent to which the university is willing to give warranties is discussed further below. In practice, on many issues the university (represented by the TTE) will be reliant on information provided to it by the academic (as university employee). There will be other matters that the academic (as founder) may be asked to warrant in a personal capacity.



The investor will always seek to impose a financial penalty should any of the warranties be breached. The existence of the penalty focuses the mind of the academic and the TTE alike, and helps to ensure that they conduct their own due diligence with care, especially in relation to encumbrances on the IP that is to be licensed.

The TTE may already have conducted some due diligence at an early stage in the spin-out project, e.g. by asking the academic to complete a detailed questionnaire. The TTE may also have information provided by the university's patent agent, e.g. on the progress of patent applications through national patent offices. Usually, the university will not have invested in infringement searches.

As part of the TTE's due diligence activities, and assuming that the university will be licensing or assigning the relevant IP to the spin-out company, the TTE should obtain any necessary assignments of IP from the relevant academics and others (e.g. collaborating institutions). Depending on the terms of any funding of the research that led to the IP being generated, it may be necessary to obtain consents from funding bodies to the transfer of IP into the spin-out company.

The TTE should consider preparing, at an early stage in spin-out discussions, a due diligence 'pack' which would be handed to the investors and which would describe, among other matters:

- How and by whom the technology was developed, and whether the developers were employees of the university
- Copies of any contracts or grant terms under which the technology was developed
- Whether the inventors are aware of having used any third party IP
- What specific IP has been created, including details of any patents, design rights, etc and the names of the inventors or other contributors to that IP
- Copies of any assignments or contracts under which the university has acquired title to such IP (e.g. from the inventors) and any other relevant documents (e.g. consents from funding bodies to the transfer of IP to the spin-out company).

A good quality, due diligence pack should assist investors to understand what IP the spin-out company will have. It may also reassure the investors about the

state of the IP so that they will be persuaded not to spend time in demanding onerous warranties from the university or the academics.

Ideally, the university should also consider whether the IP package can be bolstered prior to licensing or assigning to the spin-out company, e.g. by applying for further patents, but resource issues may limit the TTE's ability to do this in all cases.

### Key terms of the deal

Before negotiating the detailed terms of spin-out agreements, the parties will usually wish to discuss and agree the general structure of the deal, including key terms.

- The key terms will vary from deal to deal, but may include:
- A brief statement of what the company will do
- A description of the IP to be acquired by the company
- A summary of the main warranties that may be required
- The amount of the investment
- The relative shareholdings of the parties and any special rights (e.g. liquidation preferences) or restrictions (e.g. vesting periods) attaching to the investors' shares
- The composition of the Board
- The role of the academic(s) in the company
- 'Exit' strategy (i.e. how the investors will realise their investment)

### Signing a term sheet

Sometimes, the parties wish to sign a preliminary document to record their agreement in principle to the key terms of the deal. These preliminary documents have a variety of names – MOUs, letters of intent, heads of agreement, heads of terms, term sheet, etc. For convenience, they will be referred to in this Practical Guide as term sheets. The name is less important than being clear as to whether the document is intended to be legally binding. This is discussed further in Chapter 4.

## Negotiation of the detailed agreements

### Who should draft the spin-out agreements?

Investors usually require that their solicitors prepare the first drafts of the agreements, using the investors' standard templates. Where a company is being formed without external investment, some universities require that their standard templates be used.

### Brief overview of issues that come up in agreements

At this stage in the negotiations, the main focus of the TTE's attention may be on the following agreements:

#### IP agreements

- *Licence or assignment?* Is the IP to be licensed or assigned to the company? If it is to be licensed, will it be assigned at a future date, e.g. when the company has raised a defined amount of money?
- *Royalties?* Are payments to be made under the IP agreement, e.g. royalties? Generally, what terms are to be included in the agreement on issues such as licensee diligence, dealing with infringers, etc (as to which, see the Practical Guide to Licence Agreements)
- *Warranties?* What warranties is the university willing to give about the IP? And what is the limit of the university's liability for breach of warranty?
- *Improvements?* Are any improvements or further developments of the IP to be included in the deal? If so, what boundaries are to be placed on this, e.g. by time, inventor, subject-matter, lack of encumbrances, etc?
- *Research agreement?* Is a research agreement to be made between the company and the university? If so, what are the IP terms?

#### Role of academics in the company

- *Consultancy terms.* What obligations are the academics to have under consultancy agreements etc? Do these obligations conflict with the academic's duties to the university or prejudice the university's IP interests?

## Shareholders agreement and Articles of Association

- *Preferential share rights.* Preferential rights of investors in relation to their shareholdings (the trend seems to be for investors to ask for more extensive rights in recent years, e.g. anti-dilution, liquidation preference)
- *Decision-making.* Provisions giving investors veto over direction of company, etc; voting rights generally
- *Pre-emption rights.* Pre-emption rights on issue of new shares and on transfer of shares, including drag-along and tag-along rights
- *Compulsory transfer of shares.* Obligations on academic to hand back shares – good and bad leaver provisions
- *Board.* Board appointments and any special right of investor directors. Rights of university to appoint Board member or observer
- *Management.* Selection and appointment of senior management of the company
- *Business plan.* Agreement of business plan and budgets
- *University services.* Provision of services and facilities by the university to the company, e.g. company secretarial services, use of lab space, etc.
- *Use of university name.* Non-use of the university's name by the company

## Ongoing management of university interest in spin-out companies

After the spin-out agreements have been signed, and 'completion' has occurred (i.e. the investment has reached the company's bank account and the IP has been transferred into the company), the TTE may be permitted a small sigh of relief.

This is not usually the end of the project for the university. Apart from project-managing the continuing rights and obligations of the university under the spin-out agreements, a number of distinct activities may occur that involve the university in work, including:

- Appointment of the university's nominee director or observer (and perhaps providing training to him or her)
- Addressing any conflicts of interest that the academic may encounter through his or her role with the company and his or her role with the university

- Review of information from the company, e.g. status reports, accounts, budgets, etc.
- Dealing with further rounds of investment
- Dealing with any successful 'exit', e.g. on flotation
- Dealing with insolvent spin-outs

# Chapter 3

## Summary of best practice

The following points are put forward for your consideration as possible 'best practice' (on some points, readers may feel they are 'ideal practice') in relation to the preparation of spin-out agreements.

- *Policy.* Have in place an institutional policy or practice for spin-out transactions, covering such matters as:
  - The approval process for spin-out opportunities, including any criteria that should be followed when deciding whether to pursue a spin-out opportunity
  - Who will form the company (e.g. the academic in a personal capacity) and how and at what stage will the university become a shareholder?
  - Company structure generally, in the context of academic tax liabilities
  - The relative shareholdings of the relevant academic(s) and the university
  - Whether the university or its technology transfer company will be a financial investor in the company
  - Whether the university will seek to use available sources of funding to invest in the company (e.g. proof of concept funds)
  - Whether any university employee may be a financial investor in the company
  - Whether IP is to be licensed or assigned into the company; if licensed and later assigned, what are the criteria for conversion to an assignment?
  - Whether any licence or assignment is to be royalty-bearing, or is the university's return to be entirely from its shareholding (which may affect the size of the shareholding that the university requires); how any non-founder inventors are to be compensated if the licence or assignment is royalty-free
  - Whether any rights will be granted over improvements or pipelines, and if so the boundaries of any such grant, e.g. by time, inventor, etc.

- What warranties the university is prepared to give to investors, and what limits of liability it will accept; and how much due diligence the university will usually do in relation to the IP
- Whether there are any other deal terms, e.g. in relation to the preferential rights of investors, that the university would always find unacceptable
- What Board representation the university will require, and in what circumstances; who the university's representative might be (e.g. not the TTE project-managing the university's interests in the spin-out); and what training should the director receive
- Whether premises, facilities or services (e.g. accounting or company secretarial services) will be made available to the company, and whether on fully commercial terms or on 'soft' terms
- Whether the company may use the university's name, e.g. in its corporate name or in its public statements
- Advising the academic(s) to obtain their own legal advice on the transaction, particularly if they are to be individual parties to the agreements
- The extent to which the academic(s) may be involved in the company whilst remaining employed by the university
- How any conflicts of interest arising from an academic's involvement with a spin-out company will be addressed
- The role of the TTE in the spin-out process

Many universities will not have all these policies in place. Even in the universities that are most actively involved in spinning-out, policies tend to evolve over time in light of (good and bad) experience. Even if the above points are not incorporated into a formal policy, they form a useful checklist of points that the TTE should address before the transaction is completed.

- Templates. Have in place templates for spin-out transactions, including:
  - Initial questionnaire for the academic, including due diligence questions on the state of the IP and the business opportunity
  - Assignments of IP from the academic to the university (and, in appropriate cases, assignments of IP from the university to its technology transfer company)

- Confidentiality agreements and term sheets
- Memorandum and Articles of Association (recognising that outside investors may insist on using their own templates)
- Shareholder agreements (recognising that outside investors may insist on using their own templates)
- Guidelines for university directors
- Standard documents explaining the spin-out process to academics
- Guidelines for typical deal structures and terms that the university may accept in spin-out opportunities
- *Negotiation*. Who has responsibility for negotiating the terms of spin-out agreements? Do they have the required level of training and skill? Is there a procedure for referring difficult issues to a more specialist adviser (e.g. an in-house lawyer)? In what circumstances will the university instruct lawyers to represent it in negotiations?
- *Terms*. Have in place clear 'bottom lines' as to terms that must, or cannot, be accepted in spin-out agreements (see list of policy issues above).
- *Monitoring*. Implement procedures to monitor the progress of spin-out companies in which the university has a shareholding or other continuing interest (e.g. as IP licensor)





# Chapter 4

## Key negotiating issues in spin-out agreements

This chapter will focus on the core provisions of certain types of spin-out agreement. Given the variety and complexity of some spin-out transactions, the following text is not meant to be comprehensive. Some further issues are discussed in Appendix C.

### Term sheets

#### Are they legally-binding?

Once the key terms of the deal have been agreed in principle, the parties sometimes prepare a document recording these key terms. The document may be called a Memorandum of Understanding (MOU), letter of intent, heads of agreement, heads of terms or term sheet. For convenience, such documents are referred to as term sheets in this Practical Guide. The legal aspects of term sheets are discussed further in the Practical Guide to General Legal Issues.

There is no automatic assumption that term sheets are binding, or not binding, under English law. If the term sheet does not state whether it is intended to be binding, it is necessary to go back to first principles on what makes a legally-binding contract under English law (as to which, see the Practical Guide on General Legal Issues). To avoid uncertainty, the term sheet will:

- Usually state that it is not intended to be legally binding (but see below)
- Sometimes, state that one or two provisions are binding, but the rest of the document is not binding. The binding terms (if any are included) are usually:
  - Confidentiality
  - An exclusive negotiation period
- Set out the key terms of the deal (discussed above)
- Often, set out a process and timetable for agreeing terms of the spin-out agreements

## Exclusivity

The key issue in term sheets (leaving aside the commercial terms of the proposed deal that are summarised in the term sheet) tends to be whether the university is bound to a period of exclusivity with the investor, and the duration of any such period. Arguably, as the investor is not committed to invest at this stage, nor should the university be committed to negotiate exclusively with that investor. However, limited periods of exclusivity may be justified where the investor intends to devote substantial resource in due diligence or business planning as part of their pre-investment process.

Where exclusive periods are agreed, it is suggested that they should be for limited periods, e.g. 30 days, and not subject to extension at the discretion of the investor or if negotiations are continuing at the end of the 30-day period.

Sometimes, it may be more appropriate:

- To state that the negotiations are non-exclusive;
- To declare the university's intention to negotiate but state that this is non-binding and that the university may withdraw from the negotiations at any time without liability;
- To agree that the negotiations will be exclusive until such time as the university informs the investor that it intends to hold discussions with other persons (in addition to, or instead of, that investor); and/or
- To charge a fee for exclusivity, on the basis that the university is foregoing the opportunity to seek alternative sources of investment.

## Over-detailed term sheets

TTEs may wish to avoid signing term sheets that are too detailed and technical, particularly if the university has not had an opportunity to obtain legal advice on, or consider all the implications of, the wording being proposed. Term sheets with extensive IP definitions should be treated with particular caution. Some universities seem to assume that because the term sheet is not binding, the detailed wording does not matter, and can be reviewed at a later date. But investors, particularly those with a North American background, may regard the detailed wording of the term sheet as sacrosanct and accuse the university of going back on its word if it tries to propose terms in the subsequent

agreement that have a different legal effect. In some situations, where very detailed wording is encountered in a draft term sheet, it may be much better to propose a less detailed approach (or subject the wording to full legal review), rather than attempt a half-hearted revision.

## IP agreements

### **Licence or assignment; 'free' or royalty-bearing?**

An important part of any spin-out transaction is to define exactly which IP is to be 'put into' the spin-out company, and on what terms.

Once the core package of IP has been defined, two key issues are:

- whether the IP is to be licensed or assigned to the spin-out company; and
- whether the IP is to be licensed or assigned 'free of charge' (with the university's return coming exclusively from its shareholding in the company) or on normal commercial terms, which would usually include both upfront and royalty payments.

Some investors argue that:

- the company needs to own its IP (rather than be a licensee) in order to increase the value of the company and attract further investment; and
- the university is receiving shares in the company in return for transferring IP into the company, and it is inappropriate that the university should also be entitled to royalties and other payments for that IP.

Current practice amongst UK universities seems to vary substantially on these two points. Some universities resist the investors' arguments and counter with the following points:

- The transfer of IP should be by means of a licence rather than an assignment, because the university requires a degree of control over IP generated at the university. The university would not assign the IP to an established company but would license it, and similar considerations apply to spin-out companies, or more so because spin-out companies are high-risk ventures. It may also be worth pointing out that referring to the spin-out company as a high-risk venture is not to doubt the quality of the

technology that it is developing, but companies of this kind tend to be financially fragile, e.g. because they might not raise further money when it is needed, or because it costs more, or takes longer, than anticipated to reach development milestones.

- Some universities are willing to allow the licence to convert to an assignment once the spin-out company has raised a pre-defined amount of money, which gives the company a degree of financial stability.
- The university's shareholding does not represent consideration for the transfer of IP, but instead is compensation for:
  - the university's support of the academic's work
  - allowing the academic to pursue the spin-out opportunity
  - incurred expenses/investment associated with the research and intellectual property, and management time in progressing the spin-out opportunity
- In any event, by the time of any flotation or other 'exit', there may have been several further rounds of investment, which may dilute the university's shareholding to a very small percentage, and which may not represent full commercial value for the IP.
- Accordingly, the licence should be on normal commercial terms, such as those that would be agreed with an established company.
- In any event, not all of the academic inventors of the IP receive shares in the spin-out company. In order to compensate such non-shareholder inventors under the university's revenue sharing scheme, and to protect their interests, it is necessary to include financial terms in the licence agreement.
- For the reasons outlined above, some (but by no means all) universities consider that negotiations over the shareholding of the university and negotiations over the financial terms of the IP licence should not be linked.

Other universities seem to have been willing to agree royalty-free assignments. The different approaches may reflect, in part, different approaches to risk:

- Royalties are an effective anti-dilution mechanism, but they are linked to specific IP which may not remain important to the company in the future
- Equity can be diluted but the eventual returns are linked to the fortunes of the company as a whole.

As universities become more experienced in negotiating spin-out transactions, and develop their thinking on the principles that should be followed, they seem to take a firmer line on some of these issues. For example, some universities now grant a licence of IP to the company until it has reached a certain stage of financial maturity (e.g. investment of £X million or turnover of £Y million), whereupon an assignment may occur. At least one, prominent UK university will not give any commitment (i.e. as part of a spin-out transaction) to convert the licence into an assignment at a future date.

### Other commercial terms

Although an assignment can be viewed as an outright sale, this does not prevent the parties to the assignment agreement from agreeing similar commercial terms (e.g. royalty obligations) in both assignments and licences. The main differences between an assignment and a licence in this situation are:

- Where the IP has been assigned, the university's only rights (e.g. to receive a royalty, a licence back for academic use, etc) are contractual – it retains no property interest in the IP. In some situations this gives the university less control over the IP than if it had remained the proprietor. For example on any termination of the agreement as a result of the company's breach of contract, it may be more difficult to recover ownership where there has been an assignment to the company, compared with simply terminating a licence. If the spin-out company refuses to cooperate, it may be necessary to bring court proceedings to try to enforce any obligation to re-assign the IP to the university following termination of the IP agreement.
- If the spin-out company acquires ownership of the IP, it may sell it to a third party. Royalty obligations to the university will almost always be contractual obligations, which may not be binding on the new owner of the IP as it was not a party to the royalty agreement. For a brief discussion of this specialist legal point, please refer to Appendix D.

For a discussion of the implications of assignment on the insolvency of the spin-out company, please refer to Appendix D. For a discussion of the commercial terms that may be included in a licence agreement and which could also be agreed as part of an assignment of IP, please refer to the Practical Guide to Licence Agreements.

### Improvements, pipelines, research contracts and consultancies

Investors tend to be risk-averse in the contract terms that they demand from universities, usually more so than an established company that takes a licence to university IP. This may partly reflect the different perspectives of the investor and the established-company licensee. The established company may already be familiar with the general field of the licensed technology and with the development of commercial products and services in that field. It may understand, and be comfortable with, the commercial risks associated with the technology. By contrast, the investor's expertise may lie more in financial matters, and it may be relying on cautiously-drafted professional opinions on the technology and markets involved. The investor may also be used to dealing with larger investment propositions with established companies, where detailed warranties are an expected part of the transaction.

Whatever the reason, investors and their lawyers seek to close loopholes and gaps, real or perceived, that may reduce the value of the investment. Much of the documentation presented to the university by the investor can be viewed as a series of risk-reduction or risk-management terms for the investor. This partly explains the length and complexity of some of these documents. In the area of IP, these perceived risks may include:

- The risk that the next generation of technology is 'just around the corner' and may 'wipe out' the value of the spin-out company.
- The risk that the university may develop that next generation of technology and may not provide it to the spin-out company (e.g. if the academics become disenchanted with the company and seek to license subsequent inventions to another company (or even set up another spin-out!))
- The risk that the university's IP may not prevent competitive products from reaching the market, or that the IP is tainted in some way with third party rights.
- The risk that technical difficulties will prevent the technology from being developed into a commercial product without the involvement of the lead academics.

One way that the investor seeks to assess and manage these risks is through due diligence and warranties, discussed below. Another way is through seeking

to obtain both rights to future IP generated at the university and ongoing access to the lead academics. The latter way can take a number of forms:

- Asking for automatic rights to any improvements or further developments of the technology that the university may make
- Entering into a research collaboration agreement with the university under which the company acquires rights to the 'next generation' of technology
- Entering into personal consultancy agreements with the lead academics, under which they provide advice and support to the company. Usually, by the terms of the consultancy agreement, the company will own any IP generated in the course of such consultancies.

Some of the key negotiating issues for the TTE will be the following:

- *Improvements?* Is the university willing to grant rights to improvements and further developments? Some possible ways in which universities address this point are:
  - To grant no automatic rights, but maintain a regular dialogue with the company so that they know if new developments are being made. If the lead academic is a consultant to the company, this is likely to happen without the need for any contractual terms on the subject. The university may also suggest that if the company wants rights over new developments it should fund a research contract in the department under which those developments are likely to be made.
  - To grant an option to the company over very tightly-defined developments. An example of such an option agreement appears in the Practical Guide to Option Agreements. Typically such options may be limited in time (e.g. no more than 2-3 years from the date of the spin-out transaction), by department (e.g. only work done by the lead academic or under his supervision in his department, excluding any joint developments with other departments or institutions), and by source of funding (i.e. excluding work that is 'encumbered' by the rights of the sponsor or funder).
  - As an alternative or additional approach to the previous one, to grant rights only to improvements that are 'not severable' i.e. which do not generate any IP that can be used without infringing the original IP that was licensed or assigned to the spin-out company.



- *Research contract terms?* What are the IP terms of any new research contract in which the company funds work in the academic's department? Are the results of that contract automatically assigned or licensed to the company on the same terms as the original IP? Are any additional payments to be made for that new IP, e.g. upfront, milestone and royalty payments? Arguably, these results will be new technology and should be subject to arms' length IP terms such as would be applied to any other sponsor of research.
- *Consultancy terms?* What are the terms of any consultancy agreement between the academic(s) and the company, and might these potentially be detrimental to the university's IP interests? Specific concerns include:
  - Some universities require all private consultancy agreements to include wording in which the company acknowledges that it will not be gaining access to any IP of the university by virtue of the consultancy, and that the consultant is not authorised to make any commitments on behalf of the university.
  - Some spin-out companies' consultancy agreements have been adapted from employment contracts, and include (a) wording stating that the consultant's first duty is to the company, and (b) restrictions on the consultant undertaking any work, or any competing work, for any other organisation. Such provisions may need to be modified to make it clear that, as long as the academic remains an employee of the university, his first duty is to the university, and that any restrictions on the academic relate only to his activities as a private consultant, and do not restrict the university from entering into any agreement in which the academic is to perform research or other services.
  - Generally (and not just in spin-out transactions), consultancies should not be used as a disguised form of research contract, with lower overhead charges, and IP terms that tend to be more favourable to the company, than would the case with a research contract. One way of doing this is to include in the wording of the consultancy agreement a tight description of the consultancy services, i.e. one that is narrower than any services that the company may ask for across the entire range of the academic's expertise. For example the consultancy might be limited to assistance with certain aspects of the development of specific products, or attendance at the company's scientific advisory board.

## Shareholdings based on future IP

It has been known for a university to agree with an investor that the university's shareholding is partly in consideration of future IP that the university will generate, and which will be put into the company once it has been created. This has occurred with companies that are based on the expectation that valuable IP will be generated in the short to medium term, but where there is little in the way of IP at the time of the investment.

Experience suggests that agreeing to perform research work without further payment can lead to disputes, particularly if the academic becomes disenchanted with the company's management or scientific direction during the period in which the future IP is reserved for the company. It may be better to avoid shareholdings that are notionally based on future performance, and instead either:

- To justify the shareholding on the basis that the university is providing value from the outset (see discussion above); or
- To accept a lower level of shareholding at the outset, with provision for separate compensation (by additional shares or royalty arrangements) for any future IP, assuming that the university is willing to commit to provide that future IP.

### **“By helping the company, the university will benefit”**

The university may wish to resist (or at least understand the flaws in) the argument that it is benefiting from its shareholding in the company, and so should provide improvements, services, etc to the spin-out company on 'soft' terms. If the university is, say, a 10% shareholder in the company, any assets or services that the university provides without charging fully for them will, it is true, help the company. But any increase in value or viability that the company receives will benefit the university to the extent of 10% and the other shareholders to the extent of 90%. To take another example, if the company requires further financial support, it is highly unlikely that the existing investors would provide 'soft' money to help the company; any decision to provide further financial support would be taken on strictly commercial grounds. It is unrealistic to expect the university not to take the same type of investment approach as any other shareholder.

## IP warranties

The negotiation of warranties may reveal significant differences of expectation between an investor and a university.

Put simplistically, from the investor's point of view, it is investing in IP assets, and it wants to understand and limit the risks associated with those assets. As a non-specialist in IP, the investor may feel that the creator of the IP should bear some of the risk that the IP doesn't 'do what it says on the tin'. The investor's background may be in acquiring companies and established assets where it is conventional to include very extensive warranties in the sale of business agreement.

From the university's point of view, it is setting up a company that will take an academic's bright ideas and research results and turn them into commercial products. It is not in the business of taking on commercial risks associated with the IP being licensed or assigned, as would be implied by giving extensive IP warranties.

Some universities take the position that all they are prepared to warrant is that they have obtained assignments from the inventors. Specifically, they are not prepared to warrant:

- The source of the IP
- Whether the technology will work
- Whether any applications for IP will be granted
- Whether any third party, other than the named inventors, has any rights in the IP
- Whether the use of the IP will infringe third party IP
- Whether the IP will be effective to prevent third parties from competing with the company, etc, etc.

Sometimes, the investor persuades the university that it should warrant that it is not aware of any problems such as those outlined above. In such circumstances the university should be very careful to identify whose awareness is being warranted, e.g. it should be limited to a named TTE who is project-managing the IP. Given that patent applications often result in objections from the examiner or third parties, any such warranties will need very careful drafting.

Best practice may suggest that the university should not warrant anything that it does not know. But investors sometimes argue that certain facts should be known to the university (e.g. an IP ownership position). The TTE should carry out due diligence before agreeing to give any warranties. In the heat and momentum of a deal it is very easy to acquiesce to a warranty in order to 'get the deal done'; but a university is likely to take an extremely dim view of any TTE who is found to have warranted a fact (i.e. made a contractual promise) that was false, especially if the investor brings a claim for breach of the warranty.

A separate set of warranties may be sought as to the circumstances in which the IP was generated, e.g. did it result from a university project that was funded by an outside organisation, and what IP terms were associated with the funding. These types of warranties tend to be more factual, and may be easier for the university to give. But, as with all warranties, the precise wording of the warranty needs to be carefully scrutinised to ensure that it is not asking for something that the university cannot, or is not willing to, promise.

Often, in spin-out transactions, the academics who are shareholders in the company, sometimes known as founders, will be asked to give personal warranties. This is obviously a matter on which they should seek their own legal advice.

*Disclosure letters.* Conventionally, a party giving warranties makes 'disclosures against the warranties', i.e. discloses matters to the other party that are exceptions to the warranties. For example if there is a warranty that all the inventors named on a patent application are employees of the university, and the university is aware that one of the inventors was not an employee, it might disclose that fact to the investors. In corporate transactions, disclosures are usually set out in a formal disclosure letter, which is delivered to the investors at the time the shareholders agreement is signed. Disclosure letters usually include some important 'boilerplate' language (e.g. that each disclosure is made against all the warranties, even though it may refer only to one or some of the warranties). The wording of disclosure letters is a matter on which legal advice should be sought.

Some of the technical aspects of drafting warranties are discussed further in the Practical Guide to General Legal Issues.

### Limiting liability for breach of warranty

Both the university, and any academics who are giving personal warranties, will wish to limit their liability for breach of warranty. Typically, such limits are linked the value that the university and academic, respectively, are deriving from their shareholdings. In the case of academics, different limits are seen, ranging from single thousands of pounds to several tens of thousands of pounds. In the case of employees of the company, limits of up to three times annual salary are sometimes seen, although some universities would regard a cap of twice annual salary as the upper limit.

The wording of warranties, limitation of liability, and other 'legal' clauses requires particular care and should be reviewed by the university's lawyers.

## Shareholder Agreements and Articles of Association

### Introduction

Shareholder agreements (sometimes called subscription or investment agreements) tend to be lengthy documents. Together with the Articles of Association, they set out a detailed set of rules governing the relationship between the shareholders, any special rights of the investors, transfer of shares, decision-making by the Board, etc.

Some of these provisions could be included in either the Articles or the shareholders agreement or in both documents. The question of which document a provision should appear in, is discussed in Appendix C.

### Preferential share rights of investors

*Different classes of shares.* The investors will almost certainly require that they be issued with a special type of share that gives them advantages over other shareholders. A common requirement is that they receive 'preferred ordinary shares' which may carry a right to special dividends and/or enhanced voting rights, whilst other shareholders receive merely 'ordinary shares', which come bottom of the pile in any distribution of assets. Generally, companies with several shareholders may be set up with each shareholder having a different 'class' of shares, which gives the holders of each class certain 'class rights'. This may help to protect the interests of a minority shareholder – see further Appendix C.

*Decision-making.* Typically, the shareholders agreement will include a list of certain matters that cannot be decided without the investors' agreement (or sometimes there are two lists, one for shareholder decisions and one for Board decisions). Although these lists are fairly standard, they should be checked for practicality in the circumstances of the company. For example, if licensing of IP is on the list, does this make it difficult for the company to engage in ordinary trading activities?

*First return of capital.* Investors may also require that on any sale of the business or winding-up, they will receive a multiple of (e.g. twice) the amount that they invested in the company, before any remaining proceeds are distributed to the shareholders.

*Other investor advantages.* In recent years, there has been a trend for investors to include more and more special rights that are designed to protect their investment and give them advantages over other shareholders. Universities are becoming more resistant to this trend, but ultimately it comes down to the respective negotiating power of the parties.

### **Issue of new shares; transfer of existing shares**

There are several, related issues, some of which have acquired their own catchphrases (see headings below):

- *Pre-emption rights on issue.* Is a minority shareholder to be protected from the majority issuing new shares to themselves (or others) that dilute the shareholding of the minority shareholder?
- *Pre-emption rights on transfer.* If a shareholder wishes to sell his shares, must he offer them to the existing shareholders? If they decline the opportunity to acquire the shares, can the shareholder sell them to a non-shareholder or can he force the other shareholder to buy them?
- *Transfer to connected persons.* Is a shareholder to have an automatic right, despite the pre-emption provisions, to transfer his shares to a family member, family trust, etc?
- *Drag-along rights.* If a shareholder (e.g. an investor) wishes to sell his shares to a non-shareholder, can he force the other shareholders also to sell to the non-shareholder on the same terms?

- *Tag-along rights.* If a shareholder (e.g. an investor) wishes to sell his shares to a non-shareholder, must he ensure that the other shareholders have an opportunity also to sell to the non-shareholder on the same terms?
- *Compulsory transfer of shares by good/bad leavers.* Are certain shareholders (e.g. the founders, or employees of the company) required to hand back their shares to the company if they cease to be associated with the company (e.g. if they cease to be a director)? Typically, such provisions distinguish between a 'good leaver' and a 'bad leaver'. An example of a good leaver would be someone who retired on grounds of ill-health, a bad leaver might be someone who is dismissed or who voluntarily leaves before a defined date. Compulsory transfer provisions are sometimes different for managers and for founders, respectively. Indeed, founders are sometimes able to avoid compulsory transfer provisions altogether.

It has become fairly standard to include provisions along these lines in the shareholders agreement or, more usually, the Articles. Issues that are sometimes the subject of detailed negotiation include:

- the detailed mechanism for offering shares to other shareholders under pre-emption provisions
- the price mechanism on compulsory sale. Some universities take the view that it is desirable to include a provision for the Board to try to agree the price mechanism first, rather than automatically going to an external auditor to set the price. This may reduce the company's liability to pay professional fees every time someone is the subject of compulsory sale provisions. Another issue that comes up is whether the price per share should take account of the fact that the selling party is usually a minority shareholder (minority shares are treated as worth less than majority shares). Usually, a university or academic will push for the price not to be adjusted downwards to take account of this point.
- any minimum period of involvement with the company (for good and bad leaver provisions).

*Put and call options.* In addition, the parties may also agree 'put' and 'call' options, perhaps more often seen in joint venture agreements. A put option enables a shareholder (Party A) to require another shareholder (Party B) to buy

Party A's shares for a pre-defined price. A call option enables Party A to require Party B to sell Party B's shares to Party A.

### Board of directors

*Appointments.* Investors often require a right to appoint a director. Investors sometimes also require a right to appoint an observer at Board meetings, who is not a director. Usually the investor will appoint one or the other, but not both. One of the reasons that a shareholder might elect to appoint an observer rather than a director is to avoid legal responsibility for the management of the company. For example, a director may be personally liable for wrongful trading if the company is insolvent. See further, Appendix D. The university may also require a right to appoint a director and/or observer, for as long as its shareholding remains above a certain threshold (e.g. 5-10% of the issued share capital).

*Decision-making.* Further protection can be given to a shareholder by requiring that any Board meeting, in order to be quorate, must be attended by the investor-appointed director, or that director must waive his right to attend. The shareholders agreement may also provide that certain Board decisions can only be taken with the agreement of the investor-appointed director. These types of provision are rather 'heavyweight' and might sometimes be resisted by the university or other shareholders. In some circumstances, however, the university may wish to have its own veto rights, e.g. to prevent the company from taking decisions with regard to the IP that may negatively impact its value. For example, some universities may wish to have a veto over the company changing in a material way the nature of its business.

*Authority of a nominee director to represent nominating shareholder.* Some spin-out companies are not as fastidious as they should be at distinguishing between decisions that are taken by directors and decisions that are taken by shareholders, particularly if all the shareholders are represented on the Board of Directors. It may be important to clarify the extent to which a university's nominee director is authorised to take decisions on behalf of the university as shareholder. In many cases, the university will wish to make it clear that its nominee director does not have any such authority.



## Other rights and obligations in shareholder agreements

*Non-compete.* Shareholders agreements sometimes include non-compete obligations on the founders. If the university is asked to accept a non-compete obligation, it may well wish to resist it. Universities are large organisations and research may be conducted in another part of the university that might compete with the spin-out company or which might be spun out into another company. The university should not be prevented from conducting such other activities.

Personal non-compete restrictions on the academics are a matter for the academics to decide (with their own legal advice) but should not interfere with the university's research activities involving those academics.

*Use of university's name.* Another restriction that is sometimes seen in shareholders agreement is a restriction on the company making use of the university's name, either in its company name (e.g. Loamshire University Gadgets Limited) or in its publicity and marketing materials. Sometimes the company will agree with the university a statement that the company can use, that explains the company's origins with the university.

*Information flow.* It is conventional to include provisions under which each shareholder is entitled to receive management information including management accounts, either from the company or from 'its' nominated director. In the absence of such a provision, a university's nominee director might be in breach of his duties of confidentiality to the company if he provided such information to the university.

## Consultancy/secondment/employment agreements

Spin-out companies do not always have the resources or need to employ a large full-time workforce. Various methods of 'staffing' are seen, including:

- Part-time consultancies with key academics who remain employees of the university
- Temporary secondment agreements, under which university employees remain employed by the university but are seconded to work full- or part-time for the company
- Service agreements under which individuals are employed full- or part-time by the company

As has already been mentioned above, the key negotiating issues in these agreements from the perspective of the university tend to be:

- Ensuring that the university's IP is not transferred to the company by the back-door route of a consultancy agreement
- Ensuring that the consultancy agreement is not a disguised research contract, and the scope of the consultancy is clearly ring-fenced, i.e. that it is concerned with a specific technical problem or area of activity that is narrower than the general areas of interest of the academic or his department
- Ensuring that any non-compete provisions or provisions requiring the individual to give their first loyalty to the company do not conflict with the university's ongoing activities or the academic's duties to the university

Some universities have some standard language that they require the academic to include in private consultancy agreements, to make the above points clear.

There may be other matters that would concern the individuals, on which they should seek their own legal advice, e.g. liability clauses, financial arrangements, etc.

See further the Practical Guide to Consultancy Agreements.

### **Lease/facility/services agreements**

Some spin-out companies seek to use university premises and facilities to conduct their business activities. Some universities are willing to allow this for a limited period. A few universities are also willing to provide business services to spin-out companies, including accounting and company secretarial services. The TTE should be aware of the university's policy on these matters and any written guidance (e.g. in the Financial Regulations).

In general, universities seem to be taking a more 'arm's length' approach than they used to, when providing such premises, facilities and services. Responsibility for negotiating leases of university premises usually lies with an estates department or external agents, rather than the TTE. Where a lease is granted, it will usually be for a short term and without any rights to renew the

lease (the lease terms will typically include a provision under which the parties agree to apply to the county court to remove the tenant's rights to renew the lease under the Landlord and Tenant Act).

Accounting and company secretarial services are probably the province of the finance department rather than the TTE.

It is not proposed to discuss property, facility and services agreements further in this Practical Guide, other than to mention that the TTE who is project-managing the university's interests in the spin-out company should be aware of all the relationships that the company has with the university, including any key dates such as the expiry date of any lease.

# Chapter 5

## Checklist of Preliminary Issues and Provisions Commonly Found in spin-out agreements

The checklist provided below lists some key points that may need to be considered as well as the key clauses and issues usually encountered in spin-out agreements. Most are discussed further in the Appendices, particularly:

Appendix B – notes on completion of template agreements

Appendix C – in-depth discussion of commercial issues

Appendix D – special legal issues in spin-out agreements

and in other Practical Guides, including those on the subjects of:

- General Legal Issues in University Contracts
- Licence Agreements
- Option Agreements
- Confidentiality Agreements

It is assumed for the purposes of these checklists that the TTE will be faced with draft agreements prepared by solicitors acting for the investors or the company, or will instruct the university's solicitors to prepare draft agreements. In view of the range and complexity of agreements encountered in spin-out transactions, it is not recommended that the TTE should prepare agreements 'from scratch'.

The following checklists will focus on key issues. Some basic points relevant to drafting agreements (e.g. who are the parties) are covered in the checklists to be found in the other Practical Guides; in the interests of space they are not reproduced here.

### *Term sheets*

- Does the term sheet state whether it (or any term in it) is legally binding? Usually most if not all provisions should be non-binding.
- If an exclusive negotiation period is agreed, is the period clearly stated and appropriate?

- Has the IP to be transferred into the spin-out company been tightly defined?
- Has the university obtained all necessary assignments of that IP from the inventors?
- Has the university considered whether the IP can be improved or bolstered by further applications, e.g. for patents?
- Has the university investigated whether any sponsor or other third party may have rights in the IP, e.g. under the terms of any contract or grant under which the IP was developed? How are any such rights to be dealt with? (e.g. by obtaining clearances, consents or assignments from the third party?)
- If the university is giving any warranties in relation to the IP, has it investigated (e.g. with the academic) whether there any potential breaches of warranty or matters that need to be disclosed against the warranties to the company/investors?
- Is the IP to be assigned or licensed? If assignment is to take place on a future occasion, has the future occasion been tightly defined?
- Does the licence or assignment agreement include other conventional provisions to protect the university's interests? For example, does the university retain a licence to use the IP for research and teaching purposes? See further, the Practical Guide to Licence Agreements.
- Are there to be any continuing obligations on the company to the university, with respect to the IP (e.g. obligations to exploit, pay royalties, deal with infringers, etc)? If so, please refer to the Practical Guide to Licence Agreements.

- Are any rights to improvements or further developments to be granted to the company? If so, are these tightly defined in time and scope? (See discussion in chapter 4.)
- Does the university wish to recover the IP from the company in any circumstances (e.g. on insolvency)? If so, please see discussion of this point in Appendix D.

---

*Shareholder  
agreement / Articles  
of Assoc'n*

- Has the academic formed a company or does one now need to be formed (see discussion in Appendix D)? Who is dealing with the company secretarial issues including drafting of resolutions to increase the share capital, etc?
- Has the academic been told in writing that he should seek his own legal advice and that the university is not advising him?
- Has advice been obtained on the best way to structure the shareholdings in relation to the tax interests of the university and the academic, respectively (see discussion in Appendix D)?
- Has approval for the investment been obtained from the university authorities?
- Have the relative shareholdings of the university and academics been agreed?
- Amount of the investment and shares to be issued to the investors
- What preferential share rights are proposed for the investors? Are these acceptable?
- What controls do the investors have over decision-making? Are these acceptable and practical?
- What other provisions are the investors seeking that protect their minority interests, eg Board appointments, first return of capital, etc? Are these acceptable?

- What provisions should the university include to protect its minority interest (eg Board appointment)? (See discussion in Appendix C.)
- Are the pre-emption rights (on issue of new shares and transfer of shares) understandable and acceptable?
- Are the compulsory transfer provisions (eg for the academics – good/bad leaver etc) acceptable to the university?
- Are any warranties to be given by the university? Are these acceptable? Is liability limited to an acceptable amount?
- Are there any non-compete obligations on the university and/or the academic? Are these acceptable to the university? (See chapter 4)
- Should a provision be included restricting the company from using the university's name without prior consent of the university?

---

*Consultancy and  
employment contracts*

(See further, the Practical Guide to Consultancy Agreements)

- To the extent that these agreements concern university employees, do their terms adversely affect the university? (See specific points below)
- Does the agreement state that the consultant's first loyalty is to the company – if so, clarify that first loyalty is to university
- Is the extent of the consultant's commitment compatible with his duties to the university (eg is the consultancy limited to the number of days of free time that the academic is entitled to under his contract of employment)
- Is the scope of the consultancy limited so that it isn't a disguised form of research contract (see chapter 4)?

- Does the agreement clearly state that no rights to university IP are transferred to the company under the agreements?
- 

*Other contracts*

- Are any other facilities or services to be provided by the university to the company (e.g. property leases, accounting services)? Are there written agreements covering these aspects and has any other, relevant university department been involved (e.g. estates department)?





# Chapter 6

## Administration of spin-out agreements

It is important to keep track of spin-out agreements – both during the review and negotiation period and once they have been signed. A number of administrative issues may need to be addressed, including the following.

### Having a Standard Operating Procedure (SOP)

It is extremely helpful to the person negotiating the spin-out agreement if their university has an established written policy or standard operating procedure (SOP) for dealing with spin-out agreements that includes guidelines regarding particular clauses/issues. It is particularly helpful if written guidance is also issued on non-negotiable provisions as it enables the negotiator to take a more confident stance. It goes without saying that the guidance should be updated regularly and honed in light of practical issues experienced by the negotiators on a daily basis.

In addition to aiding the negotiator, having an SOP is also in the university's interest as by setting out clear guidelines (and emphasising which clauses should be referred to more senior staff or legal advisers) the potential for errors or matters to be overlooked is reduced. An SOP might usefully include:

- A checklist of provisions that should (or should not) be included.
- Guidance on when to refer particular issues upwards.
- Reminders to enter certain details of a finalised spin-out agreement on the relevant database and to send a copy to appropriate academics.
- A list of authorised signatories and the relevant procedures for holiday cover.

### Getting all the essential information for a new spin-out agreement

The academic whose IP is to be acquired by the spin-out company will often hold essential information that will enable the negotiator to understand some

or all of the relevant issues and establish a position that will best protect the interests of the university (and the academic). It may be possible to ask some standard questions of the academic in a formal questionnaire, particularly in relation to technical aspects of the IP under consideration, but other issues – e.g. information about products, markets, competitors, etc – may require further investigation, e.g. by conducting a market analysis.

Should each party appoint its own solicitors?

### **The university**

Typically, there are several parties to a spin-out transaction, including the investors, the university, the academics, and the company itself. The interests of each party will be different. In principle, therefore, each party should instruct its own solicitors to advise it in the negotiations.

In practice, universities sometimes do not instruct solicitors, usually in order to save costs. The authors have heard comments from TTEs along the lines of: “we know the investors’ solicitors from other transactions, we have a good relationship with them, and they wouldn’t take advantage of us”. It may well be true that a reputable firm of solicitors would not engage in sharp practice. But it would be misguided to assume that they would draft documentation that protects the university’s interests. Solicitors are under a professional obligation to act in the interests of their clients, in this case the investors. There may be many issues on which the investor’s solicitors, however ‘reasonably’ they are behaving, are not best placed to see the matter from the university’s point of view.

It is, of course, a matter for commercial judgment as to whether to instruct lawyers, and the authors, as practising lawyers, may be thought to have a bias on this topic. Some would say it is a false economy to avoid taking legal advice on spin-out transactions. In the authors’ view, if the university decides that it cannot afford to instruct lawyers on every spin-out, it should at least do so on some spin-out transactions, so that TTEs can build up a detailed knowledge of how the drafting of the agreements can be improved to protect their interests.

## The company

The spin-out company should appoint its own solicitors at the earliest opportunity. Some universities have a panel of solicitors that they recommend to the academics who are forming the spin-out company; other universities take the view that this is not their responsibility.

Given that the company is likely to be short of money, the company should discuss with its potential solicitors how they propose to charge for their services. Some firms of solicitors may be prepared to offer, for example:

- Fees that are dependent (wholly or partly) on the investment being received; or
- Fees that are capped at a certain level; or
- Discounted fees in return for a guarantee of continuing work

## The academics

Where academic(s) are to be parties to the spin-out agreements (e.g. in order to give personal warranties, discuss below), the university should suggest in writing to the academic(s) that they obtain their own legal advice on the transaction. Sometimes, the company's solicitors may also agree to act for the academics, at least in the early stages.

## Maintaining records and other administrative procedures

Keeping proper records of all spin-out agreements helps the TTE to ensure that the university's interests are protected. Specific measures that can be taken include the following:

- 1 Maintain a record of each spin-out agreement in an electronic database including listing key obligations under the spin-out agreement and the dates for the performance of these obligations, and have in place a system for 'flagging up' when any of these dates pass and for checking whether the obligations have been performed. If an obligation has not been performed on time, have a practice of following this up with reminder letters etc until the matter is resolved.
- 2 Make sure that each spin-out agreement is fully signed and that the original is stored safely, e.g. in an office safe and that copies of the signed version

are distributed to relevant personnel (perhaps electronically in a non-alterable pdf format).

## Making employees and others aware of their obligations

It is good practice to ensure that employees are aware of their obligations in respect of spin-out agreements. In some cases it may be appropriate to provide a copy of the spin-out agreement to the employee together with a note summarising key obligations. Where non-employees are to have obligations (e.g. students or visiting fellows), special care should be taken to ensure that they are bound by appropriate obligations, e.g. in the areas of inventions, confidentiality and publications.

# Appendices

# Appendix A – Templates

Below are examples of:

- I. Term sheet for a spin-out transaction
- II. Shareholders agreement
- III. Articles of Association

Please note that:

- These templates have been included to illustrate some of the main provisions that are encountered. They are modified versions of documents that are used by a particular UK university. They do not include all the variations that are encountered, particularly (but not only) as regards minority-protection provisions.
- Even where a “simple” agreement is required, the templates are likely to require adaptation to meet the particular requirements and circumstances of your university. It is strongly recommended that legal advice be obtained on any terms that you propose to use. This is particularly important with shareholders agreements and Articles of Association, where an in-depth understanding of company law is important when drafting or modifying such documents.
- Certain templates that may be relevant to spin-out transactions may be found in other Practical Guides. Specifically:
  - Licence agreement – please refer to the Practical Guide to Licence Agreements
  - Pipeline-type option agreement – please refer to the Practical Guide to Option Agreements
  - Confidentiality agreement – please refer to the Practical Guide to Confidentiality Agreements

## I. TERM SHEET FOR A SPIN-OUT TRANSACTION

### [XYZ] LIMITED

#### Subject to contract

These Heads of Terms are made on the \_\_\_\_\_ of \_\_\_\_\_ 200[ ]

#### Between:

1. [Name(s) and home address(es)] ("The Founder(s)"); and
2. ABC University, [address] ("University")

#### Background:

- A. The Founders have made inventions and developed technology, materials and know-how relating to [*description of technology*] ("the Technology");
- B. The Founders propose to establish a new company to commercialise the Technology;
- C. The University, by a decision of its [ ] on [date], has agreed to the establishment of the company, and to the allocation of shares in the company to the Founders and to itself in the relative proportions detailed below; and
- D. These non-binding Heads of Terms summarise the main terms that the Parties intend to incorporate in a legally-binding written agreement.

#### The Founders and the University record their current understanding as follows:

##### 1. Company formation

- 1.1 University agrees to the creation of a new company. The name of the new company shall be [*name of company*] ("XYZ").
- 1.2 XYZ will aim to [*business activity*] using the Technology.
- 1.3 A Business Plan for XYZ will be developed by [*insert party*] by [*insert date*].
- 1.4 The founding equity will be allocated as follows: [*insert agreed equity split*]



- 1.5 [Board Representation.  
[a] [ ] has the right to nominate [number] Director(s);  
[b] [ ] has the right to nominate [number] Director(s).]
- 1.6 [New appointments to be employed by XYZ are as follows: *insert details*] or [It is the intention of the Parties that XYZ will attempt to quickly recruit financial and additional technical management and it is acknowledged that the Founders will be responsible for this]
- 1.7 [The funding required is: *description of likely requirements*] or [It is the intention of the parties that XYZ will attempt to quickly raise finance and it is acknowledged that the Founders [and University] will be responsible for this fund raising.]
- 1.8 It is hoped the venture will initially be located: [*insert details*]
- 1.9 Other parties to be involved at this stage: [*insert details*]
- 2.0 It is anticipated that shareholders will get a return via a trade sale or a flotation.

## 2. Academic involvement

- 2.1 The academic principals involved are: [names and Departments]
- 2.2 [*Name of academic*]'s employer is University.
- 2.3 The capacity in which [*Name of Academic*] will be involved in XYZ is as follows:  
  
[*Insert whether consultant, director, employee etc*]
- 2.4 [The Founders][*names of Academics*] acknowledge the need to seek formal permission from the [Vice Chancellor] to act as a consultant/director of XYZ.

## 3. Research activities

- 3.1 The formation of XYZ will impose no restrictions on research and teaching activities at the University. Nor will it impose any restrictions, over and above those considered normal practice, on any publications that employees or students of the University may wish to make.

- 3.2 There is expected to be little overlap between the research in [department name]'s (the "Department") research and XYZ's activities. The potential 'competition' between XYZ and University will be handled by XYZ placing research contracts with University, and XYZ itself carrying out development, rather than research.
- 3.3 The following research collaborations are anticipated:  
[Insert details]

#### 4. Intellectual property

- 4.1 The currently available IPR to be developed by XYZ is:  
[a] from University: [name IPR]  
[b] from third parties: [name IPR]
- 4.2 [Type of IP Agreement – the IP will be transferred to XYZ via a Licence Agreement, conditional on successful fund-raising.]
- 4.3 The Fields of use to be granted to XYZ are: [All Fields of Use]
- 4.4 There is no known other University work going on which would either be usefully incorporated into XYZ, or which would compete with XYZ, but it is acknowledged that XYZ may need to access further technology from within or outside University.
- 4.5 The group where the work originates is not currently supported by any commercial sponsors.
- 4.6 The work of the Department has been supported by [name sources of funding] none of these grants relates directly to the patented work and there are thus no revenue sharing implications.
- 4.7 It is anticipated that further IPR will arise under the collaborations entered into by XYZ
- 4.8 Patent management and all costs, post completion will be handled by XYZ.

#### 5. Legal issues

- 5.1 Warranties to be made by Founders:  
[a] No other inventors or students contributed to the Technology;  
[b] No use has been made of commercial or other academic funds in developing the Technology

- 5.2 University also requires that:
- [a] Appropriate insurance is established for XYZ, at XYZ's expense;
  - [b] Directors & Officers Liability Insurance is established at as early a stage as possible, and in any event prior to any University nominee director(s) taking up their board seat;
  - [c] Appropriate tax advice is sought by XYZ and the Founders; and
  - [d] copies of all Board papers and Minutes of Board meetings shall be provided promptly to University, whether or not University's nominated director(s) attends Board meetings.
- 5.3 The responsibility for Set Up Costs will be as follows:
- [a] solicitors for University:
  - [b] solicitors for XYZ:
  - [c] solicitors for Founders:
- 5.4 Each party to be responsible for its own tax planning advice, and for seeking their own legal advice.
- 5.5 These Heads of Terms are not intended to create, evidence or imply any legal relationship or contract between the Parties. Either party may withdraw from the negotiations without liability. To the extent that any legal issue arises in connection with these Heads of Terms, it will be governed by and construed in accordance with English law.

To the best of our knowledge and belief the above statements are accurate and not misleading.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Title

\_\_\_\_\_  
Title

\_\_\_\_\_  
Date

\_\_\_\_\_  
Date

## II. SHAREHOLDERS AGREEMENT

**THIS AGREEMENT** is made as a Deed on [insert date] between:

1. [ ] whose home address is [ ]; and
2. [ ] whose home address is [ ]; and
3. ABC SPIN OUT COMPANY LIMITED (registered in England under number \_\_\_\_\_ whose registered office is at \_\_\_\_\_ ("ABC"); and
4. [ ] LIMITED (registered in England under number [ ]) whose registered office is at [ ] (the "Company").

### RECITALS:

[A] The Company is a private company limited by shares incorporated on [date] under the Companies Act 1985 (as amended by the Companies Act 1989), details of which are set out in Schedule 1.

[B] As at the date of this Deed the Company has an authorised share capital of [£100 divided into 1,000 Ordinary Shares of £0.10 each]. The shareholdings in the Company as at the date of this Deed are detailed in Schedule 1.

[C] On [ ] ABC and the Company entered into an agreement under which ABC licensed the Technology to the Company upon certain terms.

[D] The Parties have entered into this Deed, in order to record:

- [i] the basis upon which the Company will be operated;
- [ii] the regulation of the relationship between the Shareholders; and
- [iii] certain other matters.

### IT IS AGREED AS FOLLOWS:

#### 1. INTERPRETATION

- 1.1 In this Deed the following words and expressions shall, unless the context otherwise requires, have the following meanings:

<i>ABC Group</i>	means ABC and its Associated Bodies;
<i>ABC Permitted Transferee</i>	means any person to whom ABC shall have transferred its Shares pursuant to Article 9.3.6 of the Articles adopted by the Company as at Completion (or equivalent provision of the Articles adopted by the Company);
<i>Act</i>	means the Companies Act 1985 as amended from time to time;
<i>Advisory Services Contracts</i>	means the agreement in the Agreed Form to be entered into at Completion between the Company, Dr [ ] and Dr [ ] under which they will provide consultancy services to the Company;
<i>Agreed Form</i>	means, in relation to any document, the form of that document which has been agreed by the Shareholders;
<i>Articles</i>	means the Articles of Association of the Company as amended from time to time;
<i>Associated Bodies</i>	means: University of ABC; or any body corporate which is a subsidiary or holding company of ABC or University of ABC, or a subsidiary of such a holding company; or any body corporate which is principally engaged in the holding or management of investments made by or on behalf of ABC or University of ABC;
<i>Associated Party</i>	means a Founder whilst that person is a Director or whilst that person or any person to whom that person has transferred Shares pursuant to the permitted transfer provisions of the Articles remains a Shareholder;
<i>Auditors</i>	means the auditors appointed by the Company under the Act from time to time as the auditors of the Company;

<i>Board</i>	means the Board of Directors of the Company from time to time;
<i>Business Day</i>	means a day (except for Saturday or Sunday) when the clearing banks are open for business in London;
<i>Business Plan</i>	means the business plan of the Company, a copy of which is attached as Schedule 6;
<i>Completion</i>	means completion of the matters referred to in Clause 4;
<i>Completion Date</i>	means the date of this Deed or such later date as may be agreed by the Parties;
<i>Confidential Business Information</i>	means all and any Corporate Information, Marketing Information, Technical Information and other information (whether or not recorded in documentary form or on computer disk or tape) to which the Company attaches an equivalent level of confidentiality or in respect of which it owes an obligation of confidentiality to any third party and which is not readily ascertainable to persons not connected with the Company, either at all or without a significant expenditure of labour, skill or money;
<i>Consideration Shares</i>	means the Shares set out in Schedule 1, to be allotted to ABC and [ ] (pursuant to Clause 4.1) as set out against each of their names credited as fully paid up;
<i>Corporate Information</i>	means all and any information relating to the business methods, corporate plans, management systems, finances, maturing new business opportunities or research and development projects of the Company;

<i>Deed of Adherence</i>	means the deed in the form set out in Schedule 5 under which a person agrees to be bound by the terms of this Deed pursuant to Clause 6.4;
<i>Directors</i>	means the directors of the Company appointed pursuant to the Articles or the provisions of this Deed;
<i>[Disclosure Letter]</i>	[means the letter from the Founders to the Company attached hereto as Schedule 7;]
<i>Employee</i>	means any person who is or was, at any time during the immediately preceding period of six months, employed or engaged by the Company in a senior management, senior sales or senior technical position and who, by reason of such a position, possesses any Confidential Business Information or is likely to be able to solicit the custom of any customer or induce any customer to cease dealing with the Company, were he to accept the employment or engagement offered;
<i>Equity Securities</i>	shall have the meaning ascribed to it in section 94(2) of the Act;
<i>Founders</i>	means Dr [ ] and Dr [ ];
<i>Funding Round</i>	means a subscription of Equity Securities of the Company in cash effected in a single transaction;
<i>Group</i>	means a body corporate and any holding company of which that company is a wholly-owned subsidiary and any other wholly-owned subsidiary of that holding company and any other wholly-owned subsidiaries of that holding company and reference to any member of a Group shall be construed accordingly;
<i>Intellectual Property Rights</i>	means all rights in and in relation to any patent, patent applications, know-how, trade mark, trade

	mark application, trade name, registered design, copyright or other similar or analogous intellectual, industrial or commercial right, and all extensions and renewals thereof in any part of the world and any Materials in respect thereof;
<i>Issued Share Capital</i>	means all the Shares issued by the Company from time to time excluding all Shares that confer no voting, income and capital rights;
<i>Listing</i>	means the listing of all or part of the Ordinary Shares on NASDAQ, the Alternative Investment Market or the Official List of the London Stock Exchange Limited or any recognised investment exchange as defined in the Financial Services and Markets Act 2000 or such other public share or stock exchange as the Board shall determine;
<i>Marketing Information</i>	means all and any information relating to the marketing or sales of any past, present or future product or service of the Company including, without limitation, sales targets and statistics, market research reports, sales techniques, price lists, discount structures, advertising and promotional material, the names, addresses, telephone numbers, contact names and identities of customers and potential customers, commercial and technical contacts of and suppliers and potential suppliers or consultants to the Company, the nature of their business operations, their requirements for any product or service sold or purchased by the Company and all confidential aspects of their business relationship with the Company;
<i>Materials</i>	means all documents, records, tapes, disks and any other materials recording or containing Intellectual Property Rights;



<i>Parties</i>	means the parties to this Deed (including any persons who become parties to this Deed by virtue of executing a Deed of Adherence) and "Party" means any of them;
<i>Resolutions</i>	means the Shareholders' resolutions of the Company to be passed at Completion substantially in the form set out in Schedule 4;
<i>Sale</i>	means the acquisition by any person of 100 percent of the Shares or all of the Shares not already owned by the acquirer or the acquisition by any person of the whole or substantially the whole of the business and undertaking of the Company;
<i>Service Agreements</i>	means the contracts of employment in the Agreed Form to be entered into between the Company and each of Dr [ ] and Dr [ ];
<i>Shareholders</i>	means the holders of Shares and "Shareholder" means any of them;
<i>Shares</i>	means the shares in the capital of the Company for the time being;
<i>Taxation</i>	means corporation tax, advance corporation tax, income tax, capital gains tax, value added tax, stamp duty, stamp duty reserve tax, customs and other import duties, vehicle duty, general or business rates, water rates, national insurance, social security or similar contributions, payments due under section 559 Income and Corporation Taxes Act 1988, and any sum payable to any person as a result of the operation of any enactment anywhere in the world relating to taxation and all penalties, charges and interest relating to any claim for taxation or resulting from any failure to comply with any enactment relating to taxation;

*Technical Information* means all and any trade secrets, source codes, computer programs, inventions, designs, know-how, discoveries, technical specifications and other technical information relating to the creation, production or supply of any past, present or future product or service of the Company;

*Technology* means the intellectual property described in Schedule 1 of the Technology Agreement, the rights in respect of which are the subject of the Technology Agreement;

*Technology Agreement* means [the agreement referred to in Recital (C) above];

*University of ABC* means [address];

*Warranties* means the warranties and undertakings to be given by the Founders in accordance with the provisions of Clause 3.

1.2 References in this Deed to any statutory provisions shall be construed as references to those provisions as respectively amended, consolidated or re-enacted (whether before or after the date of this Deed) from time to time, and shall include any provisions of which they are consolidations or re-enactments (whether with or without amendment).

1.3 In this Deed and its Schedules:

1.3.1 “subsidiary”, “holding company”, “wholly-owned subsidiary” and “company” are to be construed in accordance with section 736 of the Act and, where appropriate, as modified by the Limited Liability Partnerships Regulations 2001;

1.3.2 references to any gender shall include all genders and the singular number shall include the plural and vice versa;

1.3.3 references to persons shall include individuals, bodies corporate, unincorporated associations and partnerships; and

1.3.4 references to Recitals, Clauses and Schedules and subdivisions of them, unless a contrary intention appears, are to the Recitals and Clauses of and Schedules to this Deed and subdivisions of them respectively.

1.4 The Schedules form part of this Deed and shall be construed and shall have the same full force and effect as if expressly set out in the body of this Deed and any reference to this Deed shall include the Schedules.

1.5 References in this Deed to the transfer of a Share shall be deemed to be a reference to a transfer or disposal of any interest in a Share.

1.6 The headings are inserted for convenience only and shall not affect the construction of this Deed.

## **2. PURPOSE OF THE COMPANY**

2.1 The Parties recognise and agree that the primary objects and purpose of the Company shall be to continue to develop and commercially exploit the Technology as set out in the Business Plan.

2.2 The Parties shall:

2.2.1 use all reasonable endeavours to procure that the Company's principal activity shall be the pursuit of the objects and purpose described in Clause 2.1; and

2.2.2 procure that the development and commercialisation of the Intellectual Property Rights of the Company is undertaken solely through the Company, except where there are specific agreements between the Company and any third party (including for the avoidance of doubt ABC and its Associated Bodies) for the development or commercialisation of the Technology.

## **3. WARRANTIES AND LIABILITY**

3.1 Each of the Founders severally warrants to the Company and ABC that so far as he or she is aware:

- 3.1.1 there are no inventors or students, other than Dr [ ] and Dr [ ], who contributed to the development of the Technology;
- 3.1.2 there is no other work being carried out by University of ABC upon which the Company is dependent or which is required by the Company to enable it to develop and commercialise the Technology as described in this Deed and the Business Plan;
- 3.1.3 there are no other Intellectual Property Rights which came into existence in the course of the development of the Technology in existence at the date of this Deed other than the Intellectual Property Rights referred to in the Technology Agreement;
- 3.1.4 there is no issued or pending patent or subsisting Intellectual Property Right which could be infringed by the Company's use of its Intellectual Property Rights;
- 3.1.5 there is no infringement by a third party of the Intellectual Property Rights of the Company;
- 3.1.6 other than the Intellectual Property Rights referred to in the Technology Agreement there is no other patent, patent application or know-how, copyright, trade mark, registered design, or applications for any of the foregoing or any computer software within that Founder's ownership or control and arising from the work of the Founders that the Company might reasonably require to exercise its rights under this Deed;
- 3.1.7 there is no substantially similar technology to the Technology being developed by any other person, nor has he or she developed any technology or product which is likely to be directly competitive with the Technology or likely to render the Technology obsolete;
- 3.1.8 the Business Plan represents the genuine commercial intent of the Founders with respect to the development of

the Technology and the business of the Company, and is based on sound and reasonable assumptions in relation to technical development, financial projections and the legal and regulatory framework under which the Company proposes to operate.

- 3.2 Each of the Warranties shall be construed as a separate Warranty and, save as expressly provided in this Deed, shall not be limited or restricted by reference to or inference from the terms of any other Warranty.
- 3.3 The Founders:
- 3.3.1 accept that the Company and ABC are entering into this Deed in reliance upon each of the Warranties and that for the purposes of Clause 3.1 the Founders shall be deemed to be aware of any matter where they could have discovered the same had they made due and diligent enquiry; and
- 3.3.2 undertake to disclose to the Company and ABC anything of a material nature which might result in a breach of any of the Warranties as soon as practicable after it comes to the notice of any of the Founders.
- 3.4 The total amount of liability of each of the Founders for damages for breach of the Warranties shall be limited to the sum of [£10,000].
- 3.5 The Founders shall have no liability in respect of any facts and circumstances giving rise to a claim under this Clause 3 to the extent that such facts and circumstances are fairly disclosed in the Business Plan [or the Disclosure Letter].
- 3.6 The Company confirms to the Founders that in entering into this Deed it has not relied on any representation, warranty or undertaking except as expressly set out in this Deed and accordingly, in relation to the Company's entering into of this Deed, the Company hereby irrevocably and unconditionally waives any right it may have to claim damages for any (mis)representation

not contained in this Deed or breach of a warranty not contained in this Deed.

- 3.7 The Company shall as soon as reasonably practicable after circumstances have come to its knowledge which will or is likely to give rise to a claim under this Deed give to the Founders by written notice details of such circumstances and such claim and will thereafter keep the Founders fully informed of all material developments relating to such circumstances and claim.
- 3.8 No claim may be brought by the Company for breach of any of the Warranties unless written notice thereof shall have been given to the Founders accompanied by reasonable particulars of the claim, including the amount of the claim, within twelve months of Completion and legal proceedings in respect of such claim have been commenced within 6 months following the service of such notice by being both issued and served.
- 3.9 The limitations in Clauses 3.5 to 3.8 shall not apply to or exclude claims against any party which are the consequence of fraud or intentional wilful deceit.

#### 4. COMPLETION

- 4.1 Completion shall take place immediately following the execution of this Deed. At Completion, the Parties shall cause Board and Shareholders' meetings of the Company to be duly convened and held to effect the following:
- 4.1.1 the passing of the Resolutions;
- 4.1.2 [the allotment and issue of the [relevant ]Consideration Shares by the Company to ABC [and [ ] (or its permitted transferee (under Clause 6.3 or article [ ] of the Articles) if so directed by ABC or [ ] (as appropriate))] and the registration by the Company of [each of] ABC [and [ ] (or such permitted transferee)] as the holder of the [relevant ]Consideration Shares and the preparation and delivery by the Company of share certificates in respect of such Shares;

4.1.3 the due execution by each of the parties thereto of the following documents:

4.1.3.1 the Advisory Services Contracts;

4.1.3.2 [the Technology Agreement;]

4.1.3.3 [the Service Agreements;]

4.1.3.4 the appointment of [ ], [ ] and [ ] as Directors and [ ], [ ] and [ ] as their respective alternates.

4.2 The Parties shall each use their respective endeavours to ensure the satisfaction of each of the steps referred to in Clause 4.1 simultaneously upon Completion.

4.3 This Deed shall, as to any of its provisions remaining to be performed or capable of taking effect following Completion, remain in full force and effect following Completion.

## **5. SHARE OPTION SCHEME**

5.1 The Parties agree that, following Completion, they will consider and, if agreed, put in place a mechanism whereby options to subscribe for up to an aggregate of 10% (after issue) of the fully diluted Issued Share Capital of the Company immediately following Completion (being the Issued Share Capital plus the number of any un-issued Shares which are the subject of granted options or any convertible loan or other instrument valid and in force at Completion, excluding Shares that do not confer voting, income and capital rights) may be granted to senior management and directors (including directors appointed by the shareholders) and staff of the Company in a prudent manner. Such options shall be granted in accordance with the rules of an employee share incentive or option plan to be proposed by the Board and submitted to the Shareholders for approval.

## **6. ISSUE, TRANSFER AND CHARGING OF SHARES**

6.1 Except as may be permitted by this Deed pursuant to clauses 6.2 and 6.3 inclusive or by the Articles or with the consent in

writing of all other Shareholders or pursuant to any agreement in writing between all the Shareholders, none of the Shareholders shall assign, transfer, mortgage, charge, pledge or otherwise dispose of or encumber in any manner whatsoever and whether in whole or in part its legal or beneficial interest in its Shares in the Company or any right or obligation under this Deed or the Articles or any other right or obligation as a member of the Company.

6.2 Except as set out in this Deed, the issue and transfer of any Shares shall be regulated in accordance with the provisions of the Articles.

6.3 A Shareholder shall be entitled at any time to transfer all or any of its Shares:

6.3.1 following [three] years from the [Completion Date], subject to Articles 9.9 to 9.23 of the Articles adopted by the Company as at Completion (with the provisions of such Articles applying herein mutatis mutandis as nearly as possible as if set out word for word in this Deed); or

6.3.2 on or following a Sale; or

6.3.3 on or following or immediately prior to a Listing.

6.4 The Parties shall procure that:

6.4.1 any transferee or allottee of Shares in the Company shall, prior to any transfer or allotment to it taking effect, have entered into a Deed of Adherence; and

6.4.2 no proposed transferee or allottee of Shares shall have their name entered in the Register of Members as a holder of any Shares unless they shall have entered into a Deed of Adherence.

6.5 On entry into a Deed of Adherence by a transferee or allottee, the transferee or allottee shall become a Shareholder and as such:

6.5.1 shall comply with the provisions of and perform all the obligations in this Deed as if it had been an original Party to this Deed; and



6.5.2 shall have the benefit of the provisions of this Deed as if it had been an original Party to this Deed (in the place of the transferor).

6.6 If any Shareholder ceases both to hold Shares [below [ ]% of the Issued Share Capital] and to be the beneficial owner of such Shares then it shall no longer be a Party to this Deed and this Deed shall cease and determine with respect to that Shareholder (except for this Clause 6 and Clauses 11 [Confidentiality], 12 [Proprietary Know-how], 17 [Shareholders' Undertakings], 18 [Restrictive Covenants], 21 [Notices] and 24 [Governing Law and Jurisdiction]); but such termination shall be without prejudice to any rights or liability which it may have in respect of any prior breach or non-performance of this Deed.

## 7. DIRECTORS AND OBSERVERS

7.1 The Founders, for so long as in aggregate they hold 5% or more of the Issued Share Capital shall jointly be entitled to appoint one Director to the Board and to remove that Director from the Board and appoint his replacement. If the Director nominated by the Founders is not a Founder himself then such appointment shall require the prior written approval of ABC, such approval not to be unreasonably withheld or delayed. The first such Director shall be [ ].

7.2 ABC or any ABC Permitted Transferee shall, for so long as it holds 5% or more of the Issued Share Capital, be entitled to appoint one (1) Director to the Board and to remove that Director from the Board and appoint his replacement. The first such Director shall be [ ].

7.3 If and whenever ABC or any ABC Permitted Transferee shall not have exercised its right to appoint a Director under Clause 7.2 or shall hold insufficient Shares to be entitled to exercise such right, it shall nevertheless be entitled (for so long as it holds Shares) to appoint and remove an observer, who may attend and speak, but not vote, at all meetings of the Board and any committees constituted by the Board and the Company shall

procure that the appointed observer shall receive the same notice of meeting of the Board or committees thereof and the same minutes and briefing papers relating thereto as a Director.

7.4 The Company, for so long as ABC or any ABC Permitted Transferee is entitled to appoint a Director under Clause 7.2 or an observer under Clause 7.3, shall send to ABC or such ABC Permitted Transferee (as the case may be) copies of all Board and committee papers at the same time as they are sent to the Directors or the members of the relevant committee.

7.5 Directors shall be entitled to be reimbursed for their reasonable out of pocket expenses (including travel, accommodation and subsistence costs) incurred when engaged in their duties as Directors or otherwise on behalf of the business of the Company. It is the intention of the Company and the Shareholders that, when the Company's finances permit and the Board agrees, non-executive Directors shall have the right to charge the Company a reasonable fee (which may be a mixture of cash and equity) in respect of their services provided that the exact remuneration paid to each such Director shall be subject to the prior approval of the Board.

7.6 The Company, at its own expense, shall take out and maintain directors' and officers' insurance (on good commercial terms) in respect of liabilities that they may incur as a result of carrying out their duties to the Company.

## **8. MANAGEMENT OF THE COMPANY**

8.1 Notwithstanding any provisions of the Articles, and save as otherwise provided in this Deed or agreed in writing by Shareholders holding at least [75]% of the voting rights at a general meeting of the Company, the Company and the Shareholders shall from time to time act, and take all necessary steps, so as to ensure that during the continuance of this Deed the Company shall be managed in accordance with the provisions of Schedule 2.

## 9. INFORMATION OBLIGATIONS OF THE COMPANY

- 9.1 The Company will provide to ABC and any shareholder holding 5% or more of the Issued Share Capital of the Company:
- 9.1.1 within 30 days of the end of each calendar quarter an information pack comprising monthly management accounts for such period, to include:
    - 9.1.1.1 a profit and loss account for the relevant months and year to date with comparison to budget;
    - 9.1.1.2 a cash flow for the relevant months and year to date with comparison to budget;
    - 9.1.1.3 a balance sheet with comparison to budget; and
    - 9.1.1.4 a report by the Chief Executive Officer of the Company (or such other person as the Company may nominate for the purpose) on the financial and operational issues in the period and reviewing anticipated future sales, expenses, cash-flow and other significant issues affecting the business;
  - 9.1.2 within 180 days after the end of each relevant financial year copies of the accounts (audited, if available) and related reports of the Company; and
  - 9.1.3 within 20 Business Days [before] [after] the start of each relevant financial year the annual budget of the Company for that financial year.
- 9.2 The Company will ensure that the Founders and ABC are promptly informed of any legal proceedings or arbitration threatened or commenced against the Company as soon as practicable after becoming aware of such action against the Company.

## 10. MATTERS REQUIRING SPECIAL APPROVAL

- 10.1 The Shareholders and the Company covenant with each other, and agree that they shall from time to time act so as to ensure, that none of the matters set out in Schedule 3 shall be agreed or undertaken without the prior consent of

Shareholders whose Shares carry [75]% or more of the voting rights at a general meeting of the Company, such consent to be signified either:

- 10.1.1 by a vote by or on behalf of the Shareholders at a general meeting of the Company, the meeting in either case having been duly convened and held; or
- 10.1.2 expressly in writing by the Shareholders.

## 11. CONFIDENTIALITY

- 11.1 Each of the Shareholders or their duly authorised representatives shall have the right to inspect the books of the Company at any time.
- 11.2 Subject always to the prior approval of the Board and to the Parties' duty of confidentiality contained in Clauses 11.3 and 11.6 below, each of the Directors of the Company may communicate any information acquired by him in relation to the Company to the Shareholder appointing him.
- 11.3 Subject to Clauses 11.4 and 11.5, no Shareholder shall at any time:
  - 11.3.1 disclose or communicate to any person or permit or enable any person to acquire any Confidential Business Information other than for any legitimate purposes of the Company; or
  - 11.3.2 use or attempt to use any Confidential Business Information in any manner which may injure or cause loss either directly or indirectly to the Company or may be likely to do so; or
  - 11.3.3 sell or seek to sell to anyone Confidential Business Information other than for any legitimate purposes of the Company; or
  - 11.3.4 obtain or seek to obtain any financial advantage directly or indirectly from the disclosure of Confidential Business Information other than for the Company.

- 11.4 Clause 11.3 shall not apply to:
- 11.4.1 information contained in this Agreement disclosed to a Shareholder's professional adviser provided that such advisers agree to keep this Agreement confidential; or
  - 11.4.2 information or knowledge which comes into the public domain other than in consequence of the default of the relevant Shareholder; or
  - 11.4.3 any information which is required to be disclosed by the relevant Shareholder by order of a court of competent jurisdiction or an appropriate regulatory authority or otherwise required by law, to the extent so required.
- 11.5 Nothing in this Agreement shall preclude any person from making a protected disclosure for the purposes of the Public Interest Disclosure Act 1998 or where required under the Freedom of Information Act 2000.
- 11.6 ABC shall be permitted to transfer Confidential Business Information to another member of the ABC Group provided that it imposes a similar duty of confidentiality on the recipient of such information.

## **12. PROPRIETARY KNOW-HOW AND NO PARTNERSHIP**

- 12.1 Save as expressly provided in this Deed (or any documents or agreements referred to in this Deed), no Party shall have any right as a consequence of this Deed to utilise any know-how or other Intellectual Property Rights licensed or assigned to the Company (whether under the Technology Agreement or otherwise) without the Company's prior written consent.
- 12.2 This Deed shall not create any partnership between the Parties or any of them.

## **13. INTELLECTUAL PROPERTY AND KNOW-HOW ON WINDING UP**

- 13.1 On the occurrence of any of the following:
- 13.1.1 the Company ceasing wholly or substantially to carry on its business otherwise than for the purpose of reconstruction or amalgamation without insolvency; or

- 13.1.2 any encumbrancer taking possession of or a receiver, administrator or trustee or similar officer being appointed over the whole or substantial part of the undertaking, property or assets of the Company; or
- 13.1.3 the making of an order or the passing of a resolution for the winding up of the Company otherwise than for the purpose of reconstruction or amalgamation without insolvency;
- 13.1.4 the Company hereby offers to assign to ABC (prior to any other person) all or any of the then existing Intellectual Property Rights relating to the Technology at a price equal to the fair value of such Intellectual Property Rights (as between a willing buyer and a willing seller contracting on arm's length terms having regard to the market value of such Intellectual Property Rights) and on such other terms as the Company and ABC may then agree.

#### **14. TAX**

- 14.1 In the event that ABC decides, acting reasonably, that a liability to income tax under the PAYE system or national insurance contributions has arisen in relation to the Shares, or that any party is notified by a tax authority of a potential liability of either the Company, ABC or University of ABC to account for income tax under the PAYE system in relation to the Shares, the Founders shall, at the written request of ABC, either:
  - 14.1.1 immediately appoint the Company as their agent to sell sufficient of the Shares acquired on exercise to meet any liability to income tax under PAYE which the Company is obliged to pay or account for to any tax authority in respect of any of the Shares; or
  - 14.1.2 pay to the Company in cleared funds within 10 Business Days of receipt of the Company's written request a sum equal to any income tax under PAYE which the Company is obliged to pay or account for to any tax authority in respect of the Shares.

- 14.2 The Founders hereby also agree to permit deductions to be made from payments of monetary earnings made to them equal to the amount of any employee national contributions which are due in relation to the Shares. Furthermore, the Founders hereby agree to indemnify ABC and University of ABC and keep ABC and University of ABC indemnified on a continuing after tax basis against any claim or demand which is made against them in respect of any liability to pay an amount of income tax under PAYE or employee national insurance contributions in respect of the Shares, including any interest or penalties imposed in connection therewith.

## 15. DURATION

- 15.1 This Deed shall continue in full force and effect for so long as any of the Parties or their successors in title or permitted assigns shall hold Shares in the capital of the Company or (if earlier) in the event of the following:
- 15.1.1 the Company is dissolved;
  - 15.1.2 there is a Listing or Sale of the Company;
  - 15.1.3 this Deed is terminated by way of a deed executed by the Parties to this Deed; or
  - 15.1.4 the issue of Shares in accordance with this Deed representing at least 10% (after their issue) of the Issued Share Capital of the Company, pursuant to a Funding Round.

## 16. ASSIGNMENT

- 16.1 No Shareholder shall assign or purport to assign or otherwise deal with any of its rights and obligations hereunder except with the express prior written consent of the other Shareholders.

## 17. SHAREHOLDERS UNDERTAKINGS

- 17.1 Each Shareholder (other than the Founders) undertakes that it will not, for so long as it holds any interest in the Shares, without the written consent of the other Shareholders solicit or endeavour to entice away from the Company any person employed or otherwise engaged by the Company whether or not

such person would commit any breach of his contract with the Company by reason of his leaving the service of the Company, provided that this Clause shall not apply to any person employed by the Company who applies for an employment position with the relevant Shareholder in response to a genuine advertisement by the relevant Shareholder in the national or trade press.

17.2 Each of the Founders agrees that he will not whilst he is an Associated Party:

17.2.1 induce or seek to induce any customer or client of the Company, to cease dealing with the Company, or to restrict or vary the terms on which any customer or client deals with the Company, or

17.2.2 solicit or endeavour to entice away from the Company, University of ABC or any Associated Body any person employed or otherwise engaged by the Company, University of ABC or any Associated Body whether or not such person would commit any breach of his contract with the Company, University of ABC or any Associated Body by reason of his leaving the service of the Company, University of ABC or any Associated Body, provided that this Clause shall not apply to any person employed by University of ABC or any Associated Body who applies for an employment position with the Company in response to a genuine advertisement by the Company in the national or trade press or whom when recruited by University of ABC or an Associated Body it was agreed with the individual that he or she may at a later stage be recruited by the Company; or

17.2.3 induce or seek to induce any person who is providing goods or services to the Company or licensing any Intellectual Property Rights to the Company or is in negotiations with the Company to provide goods or services or license Intellectual Property Rights to the Company to cease to do so or to vary the terms on which it does so.



- 17.3 The Founders hereby acknowledge that their rights to any revenue generated by or from the Technology is restricted to those rights arising from their shareholding in the Company from time to time [list any others].

## 18. RESTRICTIVE COVENANTS

- 18.1 Each of the Founders hereby covenants with and undertakes to the Company and ABC as follows:

18.1.1 Whilst he is an Associated Party and for a period of twelve months thereafter he will not, without the prior consent of the Shareholders, engage or be concerned or undertake or be interested in (whether directly or indirectly) any business (which for the avoidance of doubt shall not include an academic institution) that competes with the business of the Company. This restriction shall not apply where a Founder is the beneficial owner of shares or other securities of a body corporate whose shares are quoted on a recognised stock exchange and which, when aggregated with shares or securities beneficially owned by his spouse and/or children, total no more than 3% of any single class of shares or securities in such body corporate.

18.1.2 For a period of twelve months after he ceases (for whatever reason) to be an Associated Party he shall not whether on his own account or for any other person, firm or company:

18.1.2.1 solicit, endeavour to solicit, induce or entice any Employee to leave the employment of the Company whether or not such person would commit any breach of his contract of employment with the Company by so leaving; or

18.1.2.2 solicit, endeavour to solicit or entice away from the Company, solicit business from or deal with, in competition with the Company, any person, firm or company who or which in the preceding twelve months shall have been a

customer of or in the habit of dealing with the Company and with whom such Founder shall have dealt with in such twelve month period; or

18.1.2.3 solicit, endeavour to solicit, induce or entice any person who is engaged by the Company as a consultant, to terminate his engagement with the Company, whether or not such person would commit any breach of his consulting agreement with the Company by so terminating; or

18.1.2.4 induce or seek to induce any person who is providing goods or services to the Company or licensing any Intellectual Property Rights to the Company or is in negotiations with the Company to provide goods or services or license Intellectual Property Rights to the Company to cease to do so or to vary the terms on which it does so.

18.2 Each of the restrictions in this Clause 18 are considered by the Founders as fair and reasonable and shall be construed separately and the invalidity or unenforceability of any restriction shall not affect the others.

## **19. GENERAL**

19.1 No announcements concerning the terms of this Deed and/or any of the matters referred to herein, the Technology of the Company or its commercialisation, or the Company or its business or operations shall be made by or on behalf of the any of the Parties without the prior written consent of the others, such consent not to be unreasonably withheld or delayed, save (in the absence of consent) for any statement or disclosure which may be required by law or called for by the requirement of any recognised stock exchange, provided such statement or disclosure shall be no more extensive than is usual or necessary to meet the requirements imposed upon the Party making such statement or disclosure.

- 19.2 Save as agreed in writing, all costs and expenses, including legal costs, incurred by or on behalf of each Party in connection with the negotiation, preparation and execution of this Deed and the documents and matters herein referred to shall be borne by the Party incurring the same.
- 19.3 Any notice required to be given under this Deed shall be sufficiently given if delivered personally or forwarded by prepaid first-class post (airmail if overseas). Communications which are sent or dispatched as set out in this Clause 19.3 will be deemed to have been received by the addressee:
- 19.3.1 in the case of personal delivery, at the time of such delivery;
- 19.3.2 in the case of communication by post, on the second Business Day after dispatch in the case of delivery from and to an address in the United Kingdom and five Business Days after dispatch in any other case.
- 19.4 In proving service by post it shall be necessary to prove only that the notice was sent or dispatched and that the notice was contained in an envelope properly addressed, prepaid and posted.
- 19.5 Any notice required to be given under this Deed shall be given in writing to the addresses of each Party appearing above, or in each case to such other address or place as such Party may subsequently designate in writing to the other Parties to this Deed for the purposes of this Deed.
- 19.6 If any provision or provisions of this Deed (or of any document referred to in this Deed) is or any time becomes illegal, invalid or unenforceable in any respect, the legality, validity and enforceability of the remaining provisions of this Deed (or such document) shall not in any way be affected or impaired as a result.
- 19.7 This Deed (together with the documents referred to in it) constitutes the entire agreement between the Parties in relation to the transactions referred to in it or them and supersedes and

hereby terminates by mutual consent any previous agreement between the Parties in relation to such transactions.

- 19.8 Each of the Parties confirms that, in agreeing to enter into this Deed, it has not relied on any representation, warranty or undertaking except those contained in this Deed except to the extent that any representation has been made fraudulently.
- 19.9 No variation of any of the terms of this Deed (or of any other documents referred to in it) shall be effective unless it is in writing and signed by or on behalf of each of the Parties to it or them. The expression "variation" shall include any variation, supplement, deletion or replacement however effected.
- 19.10 If there shall at any time be any discrepancy between the provisions of this Deed and the provisions of the Articles, the provisions of this Deed shall prevail and the Parties shall take such steps as may be necessary to amend the Articles in order to give effect to the provisions of this Deed.
- 19.11 The Founders acknowledge that neither ABC nor the Company is responsible for advising the Founders on the tax liabilities that may arise in connection with their involvement with the Company in any capacity, and the Founders warrant that they have not relied on any advice from ABC or the Company in connection with such liabilities and the transactions contemplated by this Deed.
- 19.12 Except for the benefit of the provisions of clause 14 which shall be enforceable, without limitation, by University of ABC, the Parties do not intend that any terms of this Deed shall be enforceable, whether by virtue of the Contracts (Rights of Third Parties) Act 1999, common law or otherwise, by any person who is not a party to this Deed.
- 19.13 This Deed shall be governed by and shall be construed and take effect in accordance with English law. Each of the Parties submits to the exclusive jurisdiction of the Courts of England.

**IN WITNESS** whereof this Deed has been executed by the Parties and is intended to be and is hereby delivered on the date which appears first on page 1.

**EXECUTED** and delivered as a deed by ABC SPIN OUT COMPANY LIMITED acting through [two of its directors][one of its directors and its secretary]:

_____	_____
Director's signature	[Director's][Secretary's] signature

_____	_____
Print name	Print name

**EXECUTED** and delivered as a deed by [ ] LIMITED acting through [two of its directors][one of its directors and its secretary]:

_____	_____
Director's signature	[Director's][Secretary's] signature

_____	_____
Print name	Print name

**EXECUTED** and delivered as a deed by Dr [ ]:

In the Presence of:

_____	_____
Signature	Signature of Witness

_____	_____
Print name	Print Name

_____
_____
Address of Witness

**EXECUTED** and delivered as a deed by Dr [ ]:

In the Presence of:

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature of Witness

\_\_\_\_\_  
Print name

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Address of Witness

## SCHEDULE 1

### Details of the Company

(1) Company Name [ ] Limited

(2) Company Number: [ ]

(3) Date and Place of [ ]

Incorporation:

(4) Share Capital

prior to completion:

[(i) Authorised: 1,000 ordinary shares of £0.10 each

(ii) Issued: [1] ordinary share of £0.10 each

(5) Share Capital

(i) Authorised: 1,000 ordinary shares of £0.10 each  
following completion

(ii) Issued: [ ] ordinary shares of £0.10 each]

(6) Registered Office: [ ]

(7) Directors: [ ]

(8) Secretary: [ ]

(9) Accounting Reference Date: [ ]

(10) Registered Holders:

**Consideration Shares**

_____	_____	_____
_____	_____	_____

**Registered Shareholdings immediately following Completion**

Name	No. shares	Subscription price
ABC Spin Out Company Limited	[ ]	[ ]
Dr [ ]	[ ]	[ ]
Dr [ ]	[ ]	[ ]

**SCHEDULE 2**

**Management of the Company**

1. Subject to any more specific provisions of this Deed, all matters relating to the operation of the Company shall be decided by the Board and the Board shall at all times manage the Company.
2. Meetings of the Board shall be held as often as may be required for the carrying on of the Company's business, but shall, in any event, be held not less than quarterly. Not less than 5 days' notice of each such meeting specifying the date and time and place of the meeting and the business to be transacted shall be given to all Directors except in exceptional circumstances where the consent of all Directors is obtained.
3. The quorum for all meetings of the Board (or of any committee of directors appointed by the Board) shall be [two] directors, one of whom (if appointed) shall be the director appointed pursuant to clause 7.2. If a quorum is not present within half an hour of the time fixed for any such meeting, or within such longer time as those Directors present within half an hour of the time fixed for the meeting shall agree, that meeting shall be adjourned for five

Business Days to be reconvened (if possible) at the same time and place, and notice thereof shall be given to the Directors. If a quorum is not present within half an hour from the time appointed for such adjourned meeting, the quorum necessary for the transaction of the business of the Board shall be any two Directors. A person who holds office only as an alternate Director shall, if his appointor is not present, be counted in the quorum.

4. Questions arising at any meeting of the Board shall be determined by a majority of votes.
5. No borrowings shall be incurred by the Company without the prior approval of the Board.
6. The Company shall not appoint or dismiss any employee, executive or consultant with an annual remuneration in excess of £50,000 without the prior approval of the Board.  
  
The Company at its own expense, shall take out and maintain directors' and officers' insurance (on good commercial terms) in respect of liabilities that may incur as a result of carrying out their duties to the Company.
7. The Company shall obtain/comply with (as appropriate) all authorisations, permissions, consents, registrations and licences necessary for the Company to carry on its business lawfully and effectively.
8. The Company shall take all steps necessary to protect its Confidential Business Information and its Intellectual Property Rights.
9. The Company shall enter into all agreements, arrangements and obligations (including, without limitation, the licensing or leasing of or granting of rights over, any part of the Intellectual Property Rights of the Company or any other tangible or intangible capital assets of the Company) on arm's length terms.

### **SCHEDULE 3**

#### **Matters requiring Special Approval**

1. The modification of any of the rights attached to any Shares in



the Company or the creation or issue of any Shares or any other class of shares or the grant or agreement to grant any option over any Shares or any other class of shares or uncalled capital of the Company or the acceptance of any obligations convertible into Shares or any other class of shares, other than in accordance with any employee share incentive or option plan approved in accordance with Clause 5.

2. The capitalisation or repayment of any amount standing to the credit of any reserve of the Company or the redemption or purchase of any Shares or any other reorganisation of the share capital of the Company.
3. Any material departure from the Business Plan (as amended and updated from time to time by issue to the Shareholders) and/or the relevant annual budget of the Company (as adopted by the Board).
4. The acquisition or disposal by the Company of any shares of any other company or the participation by the Company in any partnership or joint venture.
5. The establishment of a subsidiary of the Company.
6. The lending of any money in excess of £50,000 in aggregate.
7. The incurring by the Company of borrowings in excess of £50,000.
8. The creation or issue or allowing to come into being of any mortgage or charge upon any part of the property or assets or uncalled capital of the Company or the creation or issue of any debenture or debenture stock other than to secure bank borrowing.
9. Any change in the accounting policies of the Company which would represent a deviation from generally accepted accounting principles.
10. The disposal or assigning to any third party of any capital assets of the Company, whether tangible or intangible (including without limitation any part of the Intellectual Property Rights of the Company or the granting of any rights over the same).

11. The amalgamation or merger of the Company with any other company or concern.
12. The declaration or payment of any dividend or the making of any distribution by the Company.
13. Other than in the ordinary course of business, the grant by the Company to any person (other than a Director) of authority to act on behalf of the Company.
14. The appointment of any person to be a Director (save as provided in this Deed).
15. The commencement or settlement of any material litigation or arbitration by the Company.
16. The appointment or removal of the Auditors by the Company under the Act.
17. Any dealings (whether of a trading nature or otherwise) between the Company and any of the Shareholders (other than in the ordinary course of business or under any contractual arrangements referred to herein) or the Directors.
18. Any acquisition by the Company of any real property (whether freehold or leasehold) and any sale, disposal or abandonment of any real property, whether freehold or leasehold, or of the whole or any substantial part of the undertaking or the assets of the Company.
19. The giving by the Company of any guarantee or indemnity other than in the ordinary course of business, which expression shall in this context include but not be limited to, the giving by the Company of any such guarantee or indemnity to (i) UK regulated banks; (ii) employees and paid advisers; and (iii) suppliers.
20. The making of any one capital commitment by the Company in excess of £25,000 and of any capital commitment if the aggregate of capital commitments made by the Company in the preceding twelve months is or would as a result be in excess of £50,000.

21. The remuneration of or granting of any pension rights (or any material alteration to any such remuneration or rights) to any Director.
22. The granting of any pension rights which require a contribution from the Company or are defined benefit in nature to any Director or employee of the Company (or any material alteration thereto).
23. The passing of any resolution for the winding-up of the Company or the making of any application to the Court to order a meeting of creditors or the making of any proposal to make a voluntary arrangement within the meaning of the Insolvency Act 1986 or the petitioning for an administration order to be made in relation to the Company.

#### **SCHEDULE 4**

##### **Shareholders Resolutions**

##### **SPECIAL RESOLUTIONS**

1. THAT:
  - (A) The Directors shall have unconditional authority to allot, grant options over, offer or otherwise deal with or dispose of any relevant securities (within the meaning of Section 80 of the Companies Act 1985 (the "Act") of the Company on and subject to such terms as the Directors may determine. The authority hereby conferred shall, subject to Section 80 of the Act, be for a period expiring on the fifth anniversary of the date on which this resolution was passed unless renewed, varied or revoked by the Company in General Meeting and the maximum amount of relevant securities which may be allotted pursuant to such authority shall be [£ ] being the authorised but as yet unissued capital of the Company at the date hereof.
  - (B) The Directors shall be entitled under the authority conferred by paragraph (A) of this Resolution or under any renewal thereof to make at any time prior to the expiry of such authority any offer or agreement which would or might require relevant securities of the Company to be allotted after the expiry of such authority.

2. THAT the Directors be given power pursuant to section 95 of the Act to allot equity securities (within the meaning of section 94 of the Act) for cash pursuant to the authority conferred by Resolution (2) as if section 89(1) of the Act did not apply to the allotment provided that this power shall be limited to the allotment of equity securities having, in the case of relevant shares (as defined for the purposes of section 89 of the Act), a nominal amount or, in the case of other equity securities, giving the right to subscribe for or convert into relevant shares having a nominal amount, not exceeding in aggregate [£ ] and shall expire on the fifth anniversary of the date on which this resolution was passed except that the Company may before the expiry of this authority make an offer or agreement which would or might require equity securities to be allotted after it expires and the directors may allot equity securities in pursuance of such an offer or agreement notwithstanding that the authority has expired.
3. THAT with immediate effect the Company adopt new Articles of Association in substitution for, and to the exclusion of, the existing Articles of Association of the Company in the form attached to this written resolution.

## SCHEDULE 5

### Form of Deed of Adherence

**THIS DEED** is made the \_\_\_\_\_ day of \_\_\_\_\_ 200[ ]

### BETWEEN:

- (1) [Name] of [Address] (the "New Party");
- (2) [ ] LIMITED (the "Company") of [ ] for itself and as attorney for the other Parties to the Subscription and Shareholders Agreement.

### RECITALS

- (A) Under the terms of an Agreement dated · (the "Subscription and Shareholders' Agreement") and entered into between Dr [ ], Dr [ ] and ABC and the Company [and to which · (the "Transferor") is [an

original Party/a Party by virtue of a Deed of Adherence dated ·) the Transferor has sold and transferred to the New Party [insert number and type of Shares] subject to the New Party entering into this Deed of Adherence/the New Party has agreed to subscribe for [insert number and type of Shares]].

- (B) The New Party wishes to accept such Shares subject to such condition and to enter into this Deed of Adherence pursuant to the terms of the Shareholders' Agreement.

### **OPERATIVE TERMS**

1. Expressions defined in the Shareholders' Agreement shall (unless the context otherwise requires) have the same meaning when used in this Deed.
2. The New Party hereby undertakes to and covenants with all the Parties to the Shareholders' Agreement (including any person who has entered into a Deed of Adherence to comply with the provisions of and to perform all the obligations in the Shareholders' Agreement so far as they become due to be observed and performed on or after the date of this Deed as if the New Party had been an original Party to the Shareholders' Agreement.
3. The New Party shall become a Shareholder [and the Transferor shall cease to be a Shareholder] and on and after the date of this Deed the New Party shall have the benefit of the provisions of the Shareholders' Agreement as if it had been an original Party to it and the Shareholders' Agreement shall be construed and apply accordingly.
4. For the avoidance of doubt, the New Party shall not be entitled to any amount which has fallen due for payment to the Transferor before the date of this Deed and shall not be liable in respect of any breach or non-performance of the obligations of the Transferor pursuant to the Shareholders' Agreement before the date of this Deed. The Transferor shall remain entitled to each such amount and shall not be released from any liability in respect of any such breach or non-performance.

**AS WITNESS** this Deed has been executed by the New Party and is intended to be and is hereby delivered on the date first above written.

**EXECUTED** and delivered as a deed by [ ]:

In the Presence of:

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature of Witness

\_\_\_\_\_  
Print name

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Address of Witness

**EXECUTED** and delivered as a deed by [ ] acting through [two of its directors][one of its directors and its secretary]:

\_\_\_\_\_  
Director's signature

\_\_\_\_\_  
[Director's] [Secretary's] signature

\_\_\_\_\_  
Print name

\_\_\_\_\_  
Print Name

## **SCHEDULE6**

### **Business Plan**

## **SCHEDULE 7**

### **[Disclosure Letter]**

### III. ARTICLES OF ASSOCIATION

#### THE COMPANIES ACT 1985

#### PRIVATE COMPANY LIMITED BY SHARES

#### ARTICLES OF ASSOCIATION OF [XYZ LIMITED] (the "Company")

Adopted by Special Resolution passed on [ ]

#### 1. DEFINITIONS AND INTERPRETATION

1.1 In these Articles:

*ABC Group* means ABC Ltd and its Associated Bodies;

*ABC Ltd* means ABC Company Limited (co. reg. no. •) whose registered office is •;

*ABC University* means [University Details];

*Acquirer* means any person including any Shareholder, acquiring or proposing to acquire any interest in Shares pursuant to Article 9;

*Act* means the Companies Act 1985 including any statutory modification or re-enactment thereof for the time being in force;

*Acting in Concert* has the meaning ascribed to it in the May 2002 edition (as amended) of the City Code of Takeovers and Mergers;

*Associated Bodies* means:

- (a) ABC University; or
- (b) any body corporate which is a subsidiary or holding company of ABC Ltd or ABC University, or a subsidiary of such a holding company; or
- (c) any body corporate which is principally engaged in the holding or management of investments made by or on behalf of ABC Ltd or ABC University;

<i>Auditors</i>	means the auditors appointed by the Company under the Act from time to time as the auditors of the Company;
<i>Board</i>	means the board of Directors of the Company for the time being;
<i>Business Day</i>	means a day (except for Saturday or Sunday) when the clearing banks are open for business in London;
<i>Connected Persons</i>	shall have the same meaning given to such expression by section 839 of the Income and Corporation Taxes Act 1988;
<i>Director</i>	means a director of the Company appointed from time to time by the Shareholders or the Directors in accordance with the terms of these Articles;
<i>Family Trust</i>	means, as regards any particular individual member or deceased or former individual member, a trust (whether arising under a settlement, declaration of trust or other instrument by whomsoever or wheresoever made or under a testamentary disposition or on an intestacy) under which no immediate beneficial interest in any of the Shares in question is for the time being vested in any person other than that individual and/or Privileged Relations of that individual; and for this purpose a person shall be considered to be beneficially interested in a Share if such Share or the income thereof is or may become liable to be transferred or paid or applied or appointed to or for the benefit of such person or if any voting or other rights attaching thereto are or may become liable



	to be exercisable by or as directed by such person pursuant to the terms of the relevant trusts or in consequence of an exercise of a power or discretion conferred thereby on any person or persons;
<i>Group</i>	means a body corporate and any holding company of which that company is a wholly-owned subsidiary and any other wholly-owned subsidiaries of that holding company and references to any member of a Group shall be construed accordingly;
<i>Issue Price</i>	means the amount paid up or credited as paid up (including any premium on issue) on the Share concerned;
<i>Listing</i>	means the listing of all or part of the Shares on NASDAQ, the Alternative Investment Market or the Official List of the London Stock Exchange plc or any recognised investment exchange as defined in the Financial Services and Markets Act 2000 or such other public share or stock exchange as the Board shall determine;
<i>Majority Change of Control</i>	means the acquisition (whether by purchase, transfer or otherwise but excluding a subscription or a transfer of Shares made in accordance with Article 9.3 by an Acquirer who, together with persons Acting in Concert with him or his Connected Persons, did not immediately prior thereto hold or beneficially own more than 50 per cent of the Shares, of any interest in any Shares if, upon completion of that acquisition, the Acquirer, together with persons Acting in Concert with him or his Connected Persons, would hold or

	beneficially own more than 50 per cent of the Shares;
<i>Ordinary Shares</i>	means the ordinary shares of £[0.001] each in the capital of the Company;
<i>Privileged Relation</i>	means, in relation to an individual member or deceased or former individual member, the husband or wife or the widower or widow of such member and all the lineal descendants and ascendants in direct line of such member and the brother and sisters of such member and their lineal descendants and a husband or wife or widower or widow of any of the above persons and for the purpose aforesaid a step-child or adopted child or illegitimate child of any person shall be deemed to be his or her lineal descendant;
<i>Sale</i>	means the acquisition by any person of 100 per cent of the Shares or all of the Shares not already owned by the acquirer or the acquisition by any person of the whole or substantially the whole of the business and undertaking of the Company;
<i>Shareholders</i>	means the holders of Shares and "Shareholder" means any of them;
<i>Shares</i>	means the Ordinary Shares and any other shares in the capital of the Company from time to time in issue; and
<i>Valuers</i>	means the Auditors, unless:  (a) report on Market Value is to be made pursuant to a deemed Transfer Notice and, within 21 days after the date of the deemed Transfer Notice, the Vendor notifies the Board in writing that it

objects to the Auditors making that report; or

(b) the Auditors decline an instruction to determine Market Value,

in which case the Valuers for the purpose of that report shall be a firm of chartered accountants agreed between the Vendor and the Board or, in default of agreement within 20 days after the event referred to in (a) or (b) above, appointed by the President of the Institute of Chartered Accountants in England and Wales on the application of the Vendor or the Board.

- 1.2 In these Articles unless the context otherwise requires:
  - 1.2.1 "subsidiary", "holding company", "wholly-owned subsidiary" and "company" are to be construed in accordance with section 736 of the Act and, where appropriate, as modified by the Limited Liability Partnerships Regulations 2001;
  - 1.2.2 words in the singular include the plural and vice versa;
  - 1.2.3 words importing any gender include all genders;
  - 1.2.4 a reference to a person includes a reference to a body corporate and to an unincorporated body of persons; and
  - 1.2.5 save to the extent modified by this Article 1, words or expressions contained in these Articles bear the same meaning as in the Act but excluding any statutory modification thereof not in force on the date of the adoption of these Articles.
2. A reference to any statute or provision of a statute includes a reference to any statutory modification or re-enactment of it for the time being in force.
3. The Company is a private company within the meaning of section 1 of the Companies Act 1985. Accordingly the Company shall not

offer to the public (whether for cash or otherwise) any Shares in or debentures of the Company or allot or agree to allot (whether for cash or otherwise) any Shares or debentures being offered for sale to the public.

4. Subject as hereinafter provided the Regulations set out in Table A of the Schedules to the Companies (Tables A to F) Regulations 1985 as amended by the Companies (Tables A to F) (Amendment) Regulations 1985 ("Table A") shall apply to this Company.
5. The following Regulations of the said Table A shall not apply to this Company: 40, 41, 42, 46, 47, 48, 50, the last sentence of 66, 73, 74, 75, 76, 77, 78, 79, 80, 88, 89, 90, 91 and the last sentence of 112.

## 6. CAPITAL

- 6.1 The authorised share capital of the Company at the date of adoption of these Articles is £[1,000] divided into [10,000] Ordinary Shares of £[0.10] each[ please amend].
- 6.2 Each Share shall carry the right to one vote at general meetings of the Company and all the Shares shall rank *pari passu* for all purposes save as set out in these Articles regardless of the nominal value thereof or the price at which they were issued.
- 6.3 Subject to Chapter VII of the Act, and to Regulation 35 of Table A, the Company may purchase its own Shares (including redeemable shares) whether out of distributable profits or the proceeds of a fresh issue of Shares or otherwise.
- 6.4 Subject to Chapter VII of the Act, any Shares may, with the sanction of an ordinary resolution, be issued on the terms that they are, at the option of the Company or the shareholder, liable to be redeemed on such terms and in such manner as the Company before the issue of the Shares may by special resolution determine, and whether out of distributable profits or the proceeds of a fresh issue of Shares or otherwise.
- 6.5 Subject to Chapter VI of the Act, the Company may give financial assistance for the purpose of or in connection with any

acquisition of Shares made or to be made in the Company or its holding company.

## 6.6 PRE-EMPTION ON ISSUE

6.6.1 Apart from any Shares to be issued pursuant to the exercise of the options granted by the Company pursuant to the Company Option, or with the prior written consent of the holders of [75]% of the Shares, any Shares in the capital of the Company which the Company proposes to allot shall first be offered for subscription to the holders of Shares in the proportion that the number of such Shares for the time being held respectively by each such holder bears to the total number of such Shares in issue. Such offer shall be made by notice in writing specifying the number of Shares to which the holder is entitled and limiting a time (being not less than twenty one days) within which the offer, if not accepted, will be deemed to be declined.

6.6.2 Shareholders who accept the offer shall be entitled to indicate that they would accept, on the same terms, Shares (specifying a maximum number) that have not been accepted by other Shareholders ("Excess Shares") and any Excess Shares shall be allotted to Shareholders who have indicated they would accept Excess Shares. Excess Shares shall be allotted pro rata to the aggregate number of Shares held by Shareholders accepting Excess Shares providing that no such Shareholder shall be allotted more than the maximum number of Excess Shares such Shareholder has indicated he is willing to accept. After the expiration of such time or upon receipt by the Company of an acceptance or refusal of every offer so made, the Board shall be entitled to dispose of any Shares so offered and which are not required to be allotted in accordance with the foregoing provisions in such manner as the Board may think most beneficial to the Company.

- 6.6.3 If, owing to the inequality in the number of new Shares to be issued and the number of Shares held by the Shareholders entitled to receive the offer of new Shares, any difficulty shall arise in the apportionment of any such new Shares amongst the holders, such difficulties shall in the absence of direction by the Company be determined by the Board on as fair a basis as possible.

## **7. LIEN**

- 7.1 The lien conferred by Regulation 8 of Table A shall attach to all Shares whether fully paid or not and to all Shares registered in the name of any person indebted or under liability to the Company whether it be the sole holder thereof or one of two or more joint holders.

## **8. TRANSFER OF SHARES**

- 8.1 The instrument of transfer of a Share may be in any usual form or in any other form which the Directors may approve and shall be executed by or on behalf of the transferor and, unless the Share is fully paid, by or on behalf of the transferee.
- 8.2 The Directors shall register any transfer of Shares which is effected with the consent in writing of all the other Shareholders or pursuant to any agreement in writing between all the Shareholders.

## **9. PERMITTED TRANSFERS, PRE-EMPTION ON TRANSFER AND OFFERS TO PURCHASE**

- 9.1 Save in accordance with Articles 9.2 to 9.25 inclusive or with the consent in writing of all other Shareholders or pursuant to any agreement in writing between all the Shareholders, none of the Shareholders shall assign, transfer, mortgage, charge, pledge or otherwise dispose of or encumber in any manner whatsoever and whether in whole or in part its legal or beneficial interest in its Shares in the Company or any right or obligation under these Articles or any other right or obligation as a member of the Company.

- 9.2 A Shareholder shall be entitled at any time to transfer all or any of its Shares:
- 9.2.1 subject to Articles 9.9 to 9.23, following three years from the date of adoption of these Articles; or
  - 9.2.2 on or following a Sale; or
  - 9.2.3 on or following or immediately prior to a Listing.
- 9.3 A Shareholder shall be entitled to transfer all or any of its Shares in accordance with the following provisions following notification to the Board:
- 9.3.1 an individual Shareholder (not being in relation to the Shares concerned a holder thereof as a trustee of a Family Trust) may transfer any of his Shares to the trustees of a Family Trust or to a Privileged Relation of that Shareholder;
  - 9.3.2 where Shares are held by trustees of a Family Trust, they may, on any change of trustees, be transferred to the new trustees of the Family Trust concerned;
  - 9.3.3 the trustees of a Family Trust may also transfer any of the Shares held by them in that capacity to a beneficiary of that Family Trust;
  - 9.3.4 Shares held by the trustees of a Family Trust may be transferred without restriction by such trustees to the trustees of another Family Trust;
  - 9.3.5 Shares may be transferred by a corporate Shareholder to another member of its Group; and
  - 9.3.6 Shares may be transferred by any member of the ABC Group to another member of the ABC Group.
- 9.4 If any trust to which Shares have been transferred pursuant to Article 9.3.1 or Article 9.3.4 ceases to be a Family Trust then the trustees of that trust shall be deemed, upon such cessation, to have served the Company with a Transfer Notice (as defined in Article 9.9) in respect of the Shares concerned.

- 9.5 If a person to whom Shares have been transferred pursuant to Article 9.3.1 ceases to be a Privileged Relation of the transferor then he shall be deemed, upon such cessation, to have served the Company with a Transfer Notice in respect of the Shares concerned.
- 9.6 If a corporate Shareholder to which Shares have been transferred pursuant to Article 9.3.6 ceases to be a member of the same Group as the original Shareholder who held such Shares then it shall be deemed, upon such cessation, to have served the Company with a Transfer Notice in respect of the Shares concerned.
- 9.7 If a Transfer Notice is deemed to have been served on the Company under Article 9.4, 9.5 or 9.6 then the provisions of Articles 9.9 to 9.23 inclusive shall apply to those Shares.
- 9.8 Any Transfer Notice deemed to have been served on the Company under Article 9.4, 9.5 or 9.6 shall be deemed not to contain a Total Transfer Condition (as defined in Article 9.10.5) and shall be irrevocable.
- 9.9 Save for a transfer as agreed in writing by all shareholders or in accordance with Articles 9.3 to 9.8 or Articles 9.24 or 9.25, any Shareholder (a "Vendor") shall, before transferring or agreeing to transfer any Share or any interest in any Share, serve notice in writing (a "Transfer Notice") on the Company of his wish to make that transfer.
- 9.10 In the Transfer Notice, the Vendor shall specify:
- 9.10.1 the number and class of Shares ("Sale Shares") which he wishes to transfer;
  - 9.10.2 the identity of the person (if any) to whom the Vendor wishes to transfer the Sale Shares;
  - 9.10.3 the price per Share at which the Vendor wishes to transfer the Sale Shares (the "Proposed Sale Price");
  - 9.10.4 any other terms relating to the transfer of the Sale Shares (and such terms may not be terms which are prohibited by these Articles); and



9.10.5 whether the Transfer Notice is conditional upon all (and not part only) of the Sale Shares being sold pursuant to the following provisions of this Article 9 (a "Total Transfer Condition").

9.11 Each Transfer Notice shall:

9.11.1 relate to one class of Shares only;

9.11.2 constitute the Company as the agent of the Vendor for the sale of the Sale Shares on the terms of Articles 9.12 to 9.23 and shall, save as provided in Article 9.13, be irrevocable; and

9.11.3 not be deemed to contain a Total Transfer Condition unless expressly stated otherwise or required by these Articles.

9.12 The Sale Shares shall be offered for purchase in accordance with this Article 9 at:

9.12.1 a price per Sale Share agreed between the Vendor and the Board; or

9.12.2 in default of agreement under Article 9.12.1 within 21 days after the date of service of the Transfer Notice, the lower of:

(i) the Proposed Sale Price; and

(ii) if the Board elects within 28 days after the date of service of the Transfer Notice to instruct Valuers for that purpose, the price per Share determined by the Valuers as their written opinion of the open market value of each Sale Share in accordance with Article 9.21 (the "Market Value") as at the date of service of the Transfer Notice.

The price per Sale Share agreed or determined in accordance with this Article 9.12 shall be referred to as the "Sale Price".

9.13 If the Market Value determined by the Valuers under Article 9.12.2(ii) is less than the Proposed Sale Price specified in the Transfer Notice, the Vendor may, subject to Articles 9.8, revoke

the Transfer Notice by written notice given to the Board within the period (the "Withdrawal Period") of 14 days after the date on which the Board serves on the Vendor the Valuers' written opinion of the Market Value.

- 9.14 The Board shall invite applications to purchase the Sale Shares at the Sale Price by a written invitation (the "Invitation") served on all Shareholders within 7 days after the Sale Price is agreed or determined under Article 9.12 or, if the Transfer Notice is capable of being revoked under Article 9.13, within 7 days after the expiry of the period for revocation in Article 9.13.

- 9.15 An Invitation shall:

- 9.15.1 specify the Sale Price;
- 9.15.2 expire 30 days after its service;
- 9.15.3 contain the other details included in the Transfer Notice; and
- 9.15.4 invite the relevant Shareholders to apply in writing, before expiry of the Invitation, to purchase the numbers of Sale Shares specified by them in their application.

- 9.16 After the expiry date of the Invitation the Board shall allocate the Sale Shares in accordance with the applications received, subject to the other provisions of these Articles, save that:

- 19.16.1 if there are applications from any class of Shareholders for more than the number of Sale Shares available for that class of Shareholders, they shall be allocated to those applicants in proportion (as nearly as possible but without allocating to any Shareholder more Sale Shares than the maximum number applied for by him) to the number of Shares of the relevant class then held by them respectively;
- 19.16.2 if it is not possible to allocate any of the Sale Shares without involving fractions, those fractions shall be aggregated and allocated amongst the applications of the relevant class in such manner as the Board thinks fit; and

19.16.3 if the Transfer Notice contained a Total Transfer Condition, no allocation of Sale Shares shall be made unless all the Sale Shares are allocated.

9.17 The Board shall, within 7 days of the expiry of the Invitation, give notice in writing (a "Sale Notice") to the Vendor and to each person to whom Sale Shares have been allocated (each a "Purchaser") specifying the name and address of each Purchaser, the number of Sale Shares allocated to him, the aggregate price payable for them and the time for completion of each sale and purchase.

9.18 Completion of a sale and purchase of Sale Shares pursuant to a Sale Notice shall take place at the registered office of the Company at the time specified in the Sale Notice (being not less than one week and not more than one month after the expiry of the Invitation, unless agreed otherwise in relation to any sale and purchase by both the Vendor and the Purchaser concerned) when the Vendor shall, upon payment to him by a Purchaser of the Sale Price in respect of the Sale Shares allocated to that Purchaser, transfer those Sale Shares and deliver the relevant share certificates to that Purchaser.

9.19 The Vendor may, during the period falling between one and six months after the expiry of the Invitation, sell any Sale Shares for which a Sale Notice has not been given by way of bona fide sale to any person at any price per Sale Share which is not less than the Sale Price, without any deduction, rebate or allowance to the proposed transferee, provided that:

9.19.1 the Board shall be entitled to refuse registration of the proposed transferee if the transferee is reasonably believed by the Board to be a direct competitor or connected with a direct competitor of any business of the Company or a nominee of such person; and

9.19.2 if the Transfer Notice contained a Total Transfer Condition, the Vendor shall not be entitled to sell only some of the Sale Shares under this Article 9.19 save with the written consent of the other Shareholders.

- 9.20 If a Vendor fails to transfer any Sale Shares when required pursuant to this Article 9, the Board may authorise any person (who shall be deemed to be the attorney of the Vendor for the purpose) to execute the necessary transfer of such Sale Shares and deliver it on the Vendor's behalf. The Company may receive the purchase money for the Sale Shares from the Purchaser and shall, upon receipt of the transfer duly stamped, register the Purchaser as the holder of those Sale Shares. The Company shall hold the purchase money in a separate bank account on trust for the Vendor but shall not be bound to earn or pay interest on any money so held. The Company's receipt for the purchase money shall be a good discharge to the Purchaser (who shall not be concerned to see to the application of it) and, after the name of the Purchaser has been entered in the register of members in purported exercise of the power conferred by this Article, the validity of that exercise shall not be questioned by any person.
- 9.21 If instructed to give their opinion of Market Value under Article 9.12.2 (ii), the Valuers shall:
- 9.21.1 act as expert and not as arbitrator and their written determination shall be final and binding on the Shareholders, save in the case of manifest error; and
- 9.21.2 proceed on the basis that:
- (i) the open market value of each Sale Share shall be the sum which a willing purchaser would agree with a willing vendor to be the purchase price for all the class of Shares of which the Sale Shares form part, divided by the number of issued Shares then comprised by that class;
  - (ii) there shall be no addition of any premium or subtraction of any discount by reference to the size of the holding that is the subject of the Transfer Notice or in relation to any restrictions on the transferability of the Sale Shares; and

(iii) any difficulty in applying either of the foregoing bases shall be resolved by the Valuers as they think fit in their absolute discretion.

9.22 The Company will use its best endeavours to procure that the Valuers deliver their written opinion of the Market Value to the Board and the Vendor within 28 days of the Board electing to instruct them under Article 9.12.

9.23 The Valuers' fees for reporting on their opinion of the Market Value shall be borne as to one half by the Vendor and as to the other half by the Purchasers pro rata to the number of Sale Shares purchased by them, unless:

9.23.1 the Vendor revokes the Transfer Notice pursuant to Article 9.13; or

9.23.2 none of the Sale Shares are purchased pursuant to this Article 9,

9.23.3 in which case the Vendor shall pay all the Valuers' fees.

9.24 Tag Along

9.24.1 Notwithstanding any other provision in these Articles, no sale or transfer or other disposition of any interest in any Shares (the "Specified Shares") shall have any effect if it would result in a Majority Change of Control unless before the transfer is lodged for registration the Acquirer has made a bona fide offer in accordance with this Article 9.24 to purchase in cash at the Specified Price (as defined in Article 9.24.3) all the Shares held by the Shareholders (except any Shareholder which has expressly waived its right to receive such an offer for the purpose of this Article 9.24).

9.24.2 An offer made under Article 9.24.1 shall be in writing open for acceptance for at least 21 days, and shall be deemed to be rejected by any Shareholder who has not accepted it in accordance with its terms within 21 days, and the consideration under such an offer shall be

settled in full on completion of the purchase and within 30 days of the date of the offer.

9.24.3 For the purpose of Article 9.24.1:

- (i) the expressions “transfer”, “transferor” and “transferee” include respectively the renunciation of a renounceable letter of allotment and any renouncer and renounee of such a letter; and
- (ii) the expression “Specified Price” means a cash amount which is the higher of:
  - (a) a price per Share equal to the highest price paid or payable by the Acquirer or persons Acting in Concert with him or his Connected Persons for any Shares (including the Specified Shares) within the last 6 months plus an amount equal to the relevant proportion of any other consideration (in cash or otherwise) received or receivable by the holders of the Specified Shares which, having regard to the substance of the transaction as a whole, can reasonably be regarded as part of the overall consideration paid or payable for the Specified Shares; and
  - (b) a price per Share equal to the Issue Price thereof.

9.25 Drag Along

- 9.25.1 If any one or more Shareholders holding between them not less than [75]% of the Shares (together the “Selling Shareholders”) wish to accept a bona fide arm’s length offer for all of their Shares, the Selling Shareholders or, after the transfer by them to the Acquirer of the Shares in question, the Acquirer shall have the option (the “Drag Along Option”) to require all the other holders of Shares to transfer all their Shares to the Acquirer or as the Acquirer shall direct in accordance with this Article 9.25.
- 9.25.2 The Selling Shareholders or the Acquirer may exercise the Drag Along Option by giving notice to that effect

(a "Drag Along Notice") to all such other Shareholders (the "Called Shareholders") at any time after the Selling Shareholders have agreed to transfer the Shares in question to the Acquirer. A Drag Along Notice shall specify the fact that the Called Shareholders are required to transfer all their Shares (the "Called Shares") pursuant to Article 9.25.1, the price at which the Called Shares are to be transferred (calculated in accordance with Article 9.25.4) and the proposed date of transfer.

9.25.3 A Drag Along Notice is irrevocable but a Drag Along Notice and all obligations thereunder will lapse if it is given before the transfer from the Selling Shareholders to the Acquirer of the Shares in question and for any reason the transfer of the Shares in question is not effected within 6 months of the date of the Drag Along Notice.

9.25.4 The Called Shareholders shall be obliged to sell the Called Shares at the price per Share at which the relevant transfer of Shares referred to in Article 9.25.1 takes place or took place.

9.25.5 Completion of the sale of the Called Shares shall take place on the date specified for that purpose by the Selling Shareholders or the Acquirer except that:

- (i) such person may not specify a date that is less than 14 days after the date of the Drag Along Notice; and
- (ii) if the Drag Along Notice is given by the Selling Shareholders, the date specified by the Selling Shareholders shall be the same date as the date proposed for completion of the sale of their Shares to the Acquirer

unless all of the Called Shareholders, the Selling Shareholders and the Acquirer agree otherwise.

9.25.6 If any of the Called Shareholders shall make default in selling its Shares in accordance with this Article 9.25, the

Acquirer or (where the Acquirer is a company) any director of the Acquirer or other person duly nominated by resolution of the Board for that purpose shall forthwith be deemed to be the duly appointed attorney of such Called Shareholders with power to execute, complete and deliver in the name and on behalf of such Called Shareholders a transfer of the relevant Called Shares and any such director may receive and give a good surcharge of the purchase money on behalf of such Called Shareholders and (subject to the transfer being duly stamped) the Company may enter the name of the third party in the register of members as the holder or holders by transfer of the Called Shares so purchased by him or them. The Board shall forthwith pay the purchase money into a separate bank account in the Company's name and shall hold such money on trust (but without interest) for such Called Shareholders until they shall deliver up a certificate or certificates for the relevant Shares to the Company and they shall thereupon be paid by the purchase money.

## **10. NOTICE OF GENERAL MEETING**

- 10.1 Regulation 38 of Table A shall be amended so that all annual general meetings and extraordinary general meetings of the Company shall be called by at least twenty-one clear days' notice. The provisions contained in that Regulation for calling a general meeting by shorter notice shall continue to apply.

## **11. PROCEEDINGS AT GENERAL MEETINGS**

- 11.1 No business shall be transacted at any general meeting of the Company unless a quorum is present. The quorum for all general meetings of Shareholders of the Company shall be [a representative of each Shareholder holding 5% or more of the voting rights at a general meeting of the Company], present in person or by proxy. If a quorum is not present within half an hour of the time fixed for any such meeting, that meeting shall be



adjourned for five Business Days to be reconvened (if possible) at the same time and place, and notice thereof shall be given to the Shareholders. If, at the adjourned general meeting, a quorum is not present within half an hour from the time appointed for such adjourned general meeting, the quorum necessary for the purposes of such adjourned general meeting shall be any two Shareholders.

- 11.2 The Chairman, if any, of the Board or in his absence some other Director nominated by the Directors shall preside as chairman of the general meeting, but if neither the Chairman nor such other Director (if any) be present within fifteen minutes after the time appointed for holding the meeting and willing to act, the Directors present shall elect one of their number to be chairman and, if there is only one Director present and willing to act, he shall be chairman.
- 11.3 At any general meeting a resolution put to the vote of the meeting shall be decided by a poll and the number or proportion of the votes recorded in favour of or against such resolution shall be recorded in the Company's minute book. Regulation 54 of Table A shall be amended accordingly. In the event of an equality of votes the Chairman shall not have a second or casting vote.
- 11.4 On a poll taken at a general meeting each Shareholder shall have one vote for each Share of which he is the holder.
- 11.5 For the purposes of a resolution in writing pursuant to Regulation 53 of Table A the execution, in the case of a corporation, by a director or the secretary thereof and, in the case of joint holders of a Share, by or on behalf of any one of such joint holders, shall be sufficient.

## 12. DIRECTORS

- 12.1 The quorum for all meetings of the Board (or of any committee of directors appointed by the Board) shall be two Directors. If a quorum is not present within half an hour of the time fixed for any such meeting, or within such longer time as those Directors

present within half an hour of the time fixed for the meeting shall agree, that meeting shall be adjourned for five Business Days to be reconvened (if possible) at the same time and place, and notice thereof shall be given to the Directors. If a quorum is not present within half an hour from the time appointed for such adjourned meeting, the quorum necessary for the transaction of the business of the Board shall be any two Directors. A person who holds office only as an alternate Director shall, if his appointor is not present, be counted in the quorum.

12.2 Any Director may participate in a meeting of the Board by means of conference telephone or similar communications facilities whereby all the Directors participating in the meeting can hear each other and all the Directors participating in a meeting in this manner shall be deemed to be present in person at such meeting.

12.3 A director or the secretary of a corporation shall be deemed to be a duly authorised representative of that corporation and shall be entitled to exercise the same powers on behalf of that corporation as that corporation could exercise if it were an individual shareholder, creditor or debenture holder of the Company.

12.4 Subject to the provisions of these Articles, the Directors may regulate their proceedings as they think fit. A Director may, and the secretary at the request of a Director shall, call a meeting of the Board. It shall be necessary to give at least 7 clear days' notice of such meeting to all Directors (even if not in the United Kingdom), unless all Directors accept shorter notice. Resolutions of a meeting of the Board shall be approved if and only if a majority of votes of the Directors are cast in favour thereof. In the case of an equality of votes, the chairman shall not have any second or casting votes. A Director who is also an alternate director shall be entitled, in the absence of his appointor, to a separate vote on behalf of his appointor in addition to his own vote.

12.5 A Director need not hold Shares in the Company, and no Director shall be subject to retirement by rotation.

- 12.6 The Company shall not be subject to section 293 of the Act and accordingly any person may be appointed as a Director, whatever his age, provided that such appointment is in accordance with any agreement between the Shareholders, and no Director shall be required to vacate his office of Director by reason of his attaining or having attained the age of seventy years or any other age.
- 12.7 Subject to the provision of section 317 of the Act a Director may contract with the Company and participate in the profits of any contracts or arrangements involving the Company as if he were not a Director. A Director shall also be capable of voting in respect of such contracts or arrangements, where he has previously disclosed his interest to the Company, or in respect of his appointment to any office or place of profit under the Company, or in respect of the terms thereof, and may be counted in the quorum at any meeting at which any such matter is considered.

### **13. BORROWING POWERS OF THE DIRECTORS**

- 13.1 The Directors of the Company may exercise all the powers of the Company to borrow money, whether in excess of the nominal amount of the share capital of the Company for the time being issued or not, and to mortgage or charge its undertaking, property or uncalled capital, or any part thereof, and subject to section 80 of the Act to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

### **14. INDEMNITY**

- 14.1 Subject to the provisions of the Act, but without prejudice to any other indemnity to which the person concerned may otherwise be entitled, every Director, alternate Director, secretary or other officer of the Company (not including the Company's auditors) shall be entitled to be indemnified by the Company against all costs, charges, losses, expenses and liabilities incurred by him in the execution and discharge of his duties. Regulation 118 of Table A shall be extended accordingly.

- 14.2 The Directors may exercise all the powers of the Company to purchase and maintain for every Director or other officer insurance against any liability for negligence, default, breach of duty or breach of trust or any other liability which may be lawfully insured against.

## **15. THE COMPANY SEAL**

- 15.1 Pursuant to section 36A of the Act, as introduced by section 130 of the Companies Act 1989, the Company can execute documents and deeds without the use of a seal, and any Share certificate signed by a Director and Secretary or by two Directors shall be as valid as a certificate sealed with the seal of the Company, and Regulations 6 and 101 of Table A shall be amended accordingly. The Company may in accordance with section 39 of the Act have an official seal for use in any territory, district or place elsewhere than in the United Kingdom, but the official seal shall only be used by a Director and Secretary or by two Directors or by such person or persons on such occasions and in such circumstances as are specifically authorised by a resolution of the Board, who shall have the authority to amend, suspend or withdraw such authority as they think fit.

# Appendix B

## Completing the template agreements

### Introduction

TTEs are required to draft many types of agreement, including most of those that are the subject of templates in the Practical Guide series. Shareholders agreements and Articles of Association may be the exception. These documents tend to be drafted by lawyers, or company secretaries with specialist training. The degree of knowledge of company law that is required in order to prepare these documents makes it difficult for most TTEs to draft them with confidence.

This Appendix will therefore limit itself to commenting on the template for a term sheet.

The term sheet (or heads of terms) in Appendix A comprises some key terms that are likely to be of interest to a university and the founding academics at the stage when the university is giving its approval for the formation of the company. It is not intended to be a legally binding document (see final clause) and does not include 'legal' language of the kind that would typically be found in a shareholders agreement or other detailed contract. For a discussion of various aspects of term sheets, see Practical Guides on General Legal Issues, and the Practical Guide on Key Issues, respectively.

It should be pointed out that some of the terms in the template reflect the approach of a particular university. For example, the authors are aware that some universities will not consider giving consent to a spin-out company formation until a business plan has been prepared, whereas the term sheet included here anticipates that a business plan will be prepared at a future date. The term sheet will therefore need to be adapted to reflect the practices of your university, with clauses added, deleted or modified as appropriate.

Otherwise, the term sheet is fairly self-explanatory.

# Appendix C

## Discussion of commercial issues in spin-out agreements

### Introduction

This Appendix will focus on some commercial issues in spin-out transactions. The main topics to be covered will be:

- Minority protection provisions
- Due diligence
- Shareholdings
- Board of directors
- Academic involvement in the company
- Conflicts of interest
- Employees
- Share options

The following paragraphs should be read in conjunction with Chapter 4, where some key negotiating issues are discussed.

Some legal issues that are relevant to spin-out transactions are discussed in Appendix D, including:

- Formalities of incorporation
- Tax issues
- Insolvency of spin-out companies

General legal issues are discussed in the Practical Guide entitled 'General Legal Issues in University Contracts', which covers, among other matters:

- Backdating the agreement
- Parties
- Law and jurisdiction
- Injunctive relief
- Export control laws

### How can a minority shareholder (e.g. the university) protect itself against the majority?

There are several ways in which a minority shareholder can seek to protect its interests from the actions of the majority. The main two ways are:

- By enforcing rights that a shareholder has under company and general law, e.g. to seek a court order:
  - For a remedy for 'unfairly prejudicial conduct'
  - To wind-up the company because it is 'just and equitable to do so' or
  - To restrain 'fraud or oppression on the minority'
- By including contractual rights in any shareholder agreement and in the Articles.

It should be emphasised that the enforcement of rights under general company law, although available, is not always a practical remedy in relation to spin-out companies. High Court litigation is very expensive and the remedy provided by the Court may be simply that one party must purchase another party's shares, which will not always be in the university's interests.

In addition, if the shareholder's percentage shareholding is above certain thresholds (at the time of writing, particularly 10% and 25%), the shareholder has certain rights to veto decisions by the company, e.g. a resolution to change the Articles of Association requires a 75% majority of shareholders.

### Contractual protection

The main contractual provisions that can be agreed to protect a minority shareholder include those summarised below. Some of these (e.g. the right to appoint a director) are regularly included in spin-out agreements by both the investor and the university, whilst some others tend to be included only by the investor. The university should not overlook the possibility of including many or all of these provisions with a view to protecting its interests vis-à-vis the other shareholders.

- A right to appoint a member of the Board of Directors
- A right of consultation or veto over major decisions

- Protection against dilution of one's shareholding (e.g. pre-emption rights on new issues of shares)
- Provisions on the proper distribution of profits (e.g. dividend policy)
- Access to information (e.g. management accounts)
- Safeguards to enable the company to assert claims against the majority shareholder if the latter is in breach of its obligations to the company (e.g. by delegating decisions on such matters to a committee on which the majority shareholder does not sit)
- An ability to 'exit' the company (e.g. by 'put' options requiring the other shareholders to buy one's shares)
- By giving each shareholder 'class rights' (e.g. if the university's shares are in Class A and the investor's shares in Class B). Certain actions by the majority can be blocked if they 'vary' the class rights of any class of shareholder. However, bear in mind that having separate classes of shares may make it more difficult to operate an EMI share option scheme (as to which, see below).

The above list summarises the main areas where contractual provisions can help to protect a minority shareholder. In each of these areas, detailed clauses can be included. This is a very brief summary of a topic that raises complex issues of company law. Readers should consult their solicitors as to possible clauses that may be included and the wording of such clauses.

### **Where should these provisions be put – shareholders agreement or Articles?**

Some of the above provisions could be included in either the shareholders agreement or the Articles of Association or both. There are some technical, legal issues that may need to be considered when deciding where best to place these provisions, on which the university's solicitors can advise. It may be helpful to mention a couple of practical considerations:

- The Articles of Association are publicly-available from Companies House, unlike the shareholders agreement. For example, it may be important for a purchaser of shares from an existing shareholder to know of any pre-emption provisions that the shareholders have agreed, which would be an argument for including them in the Articles. Other provisions, e.g. warranties or non-compete obligations, might be better kept private, in the shareholders agreement.



- Usually, a shareholders agreement can only be amended with the agreement of all shareholders (unless they agree otherwise), whereas the Articles can be amended by a special resolution of (at least 75% of) the shareholders. In some situations, particularly if the shareholders hold different classes of shares, it may be more difficult for the majority to make changes at the expense of the minority.

### **Due diligence**

The general subject of due diligence is discussed in more detail in the Practical Guide to Key Issues in Technology Transfer. In the context of spin-out transactions, the investors will usually wish to undertake due diligence investigations. In addition, as the university may be asked to give warranties about its state of knowledge on certain points, the university may also wish to undertake a due diligence exercise. Areas for investigation by the university may include:

- Who invented or created the technology
- Were they employees of the university
- Have they assigned their rights to the university
- If an invention was made in the course of a research project, who funded the project
- What contract terms governed the funding, e.g. in relation to IP and commercialisation rights
- Did the inventors knowingly include any third party IP (e.g. by incorporating freeware into a university software package)
- Have any significant problems emerged in the course of patent filing, e.g. objections from examiners

As was mentioned earlier in this Guide, the TTE may wish to put together a due diligence 'pack' that addresses the above issues and which would be presented to investors.

The investors may have additional areas of enquiry, including whether the technology works, has a market, the size of the market, is subject to competitors, etc. These areas may fall outside the university's knowledge.

### **What percentage share should the university get in the spin-out company?**

The relative shareholdings of the parties is a matter for commercial negotiation. Some universities have developed policies on what they would expect to receive, as in the following examples:

- According to at least one university, the relative shareholdings of the academic(s) and the university should be one-third to the academic(s) (collectively) and two-thirds to the university.
- According to at least one university, the university should receive 20% of the company's issued share capital, post-seed funding but pre-substantial investment.

These examples are given for illustration purposes only. There seems to be a wide variation in approaches. This may depend partly on whether the university is expecting to receive royalties and other payments under any IP agreement, in addition to a shareholding. Investors may be less inclined than academics to accept any 'policy' of the university in this area.

In some situations, if the university keeps its shareholding below 25%, it is understood that this may facilitate the company in obtaining government grants.

### **Should the university invest money in the spin-out?**

Some universities are willing to arrange for non-university funds over which they have a degree of control, e.g. proof of concept funds, to be made available to a spin-out company. One university's approach is that funds in the range £5,000 to £20,000 might be made available in this way. Some universities have other sources of funding, e.g. its technology transfer company may have funds available. Universities are usually not willing to invest their own funds in spin-out companies.

## Board of directors

### **Should the university appoint a Board member or observer?**

Some universities wish to appoint a director to the spin-out company. Others take the view that they do not wish to participate in the management of the

company and therefore would always appoint an observer rather than a director. Usually, under the terms of the shareholders' agreement, any right of appointment ceases once the university's shareholding is diluted down below a pre-agreed percentage of the issued share capital of the company (usually in the 5%-10% region). One of the factors that may cause the university to appoint an observer rather than a director is that, in some situations, directors may be personally liable for their actions or inactions as a director. See the discussion of directors' duties and wrongful trading in Appendix D.

### **Shadow directors**

Whether or not the university appoints a director, it (and any observer that it appoints) should be careful not to act as a 'shadow director'. A shadow director is any person (which may be an individual or an organisation) who, although not a director, is a person in accordance with whose instructions the Board is accustomed to act. Shadow directors have the same potential liability as directors. For example, where the Board of a company is 'told what to do' by its parent company, the parent company might be treated a shadow director.

### **Who should the university's director be?**

In the last few years, some universities have moved away from their previous practice of appointing TTEs as the university-nominated directors of spin-out companies. Instead, such universities now tend to appoint people from outside the university, e.g. experienced industrialists. The advantages of this new approach include:

- Obtaining industry-specific experience
- A clearer delineation of the role of the university as a shareholder (and of the TTE as project manager of the university's interests as a shareholder) and not as a director or manager of the company
- A clearer distinction between the company as a commercial enterprise and the academic department from which the company has sprung (or spun)

### **Training for directors**

Some universities provide training for the directors that they nominate to spin-out companies, on such issues as:

- Directors' legal duties

- Wrongful trading
- What the university expects from the director

### **Academic involvement in the company**

The extent of an academic's involvement in a spin-out company will depend on a number of factors, including:

- How much further R&D is needed to convert the technology into marketable products and services
- How suited the academic is to working in a commercial environment, whether he wants to commit time and energy to doing so (and whether he can do so in light of his other commitments, e.g. as a university employee), and whether he 'gets on' with the senior management of the company

### **Conflicts of interest**

Many universities now have formal policies on the subject of conflicts of interest. In certain situations, it may be inappropriate for an academic to have a relationship with a spin-out company (e.g. as shareholder, director, consultant) and also be involved in contracts between the spin-out company and the university. Alternatively, any such multiple relationships may need to be officially notified to the university so that they are 'in the open' and can be monitored. An example that is sometimes given of an inappropriate relationship, is where an academic is commissioned by the spin-out company to conduct clinical trials on humans and is also a shareholder or director of the spin-out company. This is not the only conflict of interest that may cause concern, but it is a particularly prominent one, in view of concerns about patient safety.

Conflicts of interest may have other adverse effects, including damage to the reputation of the university. The subject of conflicts of interest is discussed further in the Practical Guide to Key Issues in Technology Transfer.

## **Employees**

### **Contracts of employment**

Sometimes, an academic will join the spin-out company as a full-time employee, or commercial manager(s) will be recruited from outside the university to be employees of the company. Typically, senior employees will be

asked to sign a detailed contract of employment (sometimes called a 'service agreement'). As well as covering the usual topics of employment contracts, the service agreement may cover areas such as the employee's position as a director of the company, any bonus arrangements, and detailed clauses on issues such as IP, confidentiality and non-competition (non-compete clauses being also known as 'restrictive covenants').

### **Secondment agreements**

Sometimes, the university will second employees of the university to work at the spin-out company. The seconded employee will remain employed by the university but his or her duties will be to work at the spin-out company. Secondment agreements deal with similar issues to employment contracts, but also address certain obligations of the university and the spin-out company to one another.

### **Share options**

Share options are a low-cost method of providing a financial incentive to employees. They are particularly popular with small- to medium-sized, technology-based companies. Certain types of share option agreement and scheme attract tax advantages (usually, the right to defer payment of income and capital gains tax until a financial return has been realised). Without these tax advantages, the issue of share options to an employee would attract an income tax liability at the time of issue, long before any gain has been realised.

A popular type of share option scheme for smaller companies is the Enterprise Management Incentive (EMI) scheme, which has been described by the author of the ICSA Employee Share Schemes Handbook, David Craddock, as "the most tax-advantageous employee share scheme ever introduced in the UK". There are various alternative types of scheme which have fewer tax advantages than EMI, as EMI is not always available or appropriate.

When planning the future shareholdings of the various parties to a spin-out transaction, it is usual to plan on the basis that approximately 10% of the authorised share capital will be required for issue to employees under share options schemes. Allocating more than 10% to employees may create (extra) tax issues and would breach the guidance of the Association of British Insurers

(ABI), the latter being more relevant to listed companies. These are matters on which the TTE's tax advisers will be able to assist.

Share option schemes need to be set up and administered carefully in order to comply with Inland Revenue rules (including tax avoidance rules), and it will usually be appropriate to involve a specialist legal/tax adviser. It should also be borne in mind that the tax rules change frequently, and that arrangements that were tax-effective in the last transaction may not work in the next, similar transaction.

# Appendix D

## Special Legal Issues in Spin-out Agreements

### Stop press

The Company Law Reform Bill, once enacted (probably in 2006), will make extensive changes to UK company law. Some of the changes will apply only to private companies, and are designed to simplify the legal regime. The Bill proposes to make changes in the following areas, among others:

- To codify directors' duties
- To make it easier for a director to avoid having his home address included on the public register
- To abolish the requirement to appoint a company secretary
- To simplify the Memorandum of Association
- To change the voting thresholds (i.e. the percentage of votes that is required) for decision-making on different issues

The following discussion refers to current law and not to the changes that would be introduced if the Bill were enacted in its current form.

### Sending out business plans

The university may wish to inform the academic(s) that seeking investment for companies is a regulated activity, and that they should seek advice from their solicitors, accountants or other advisers who have the necessary regulatory approval to conduct investment business.

### Formalities of company formation

Spin-out companies are often formed by the academic, for tax reasons (see below). Where a TTE is involved in forming a company, the following summary may be of assistance.

### Company registration

Where a company is incorporated in England and Wales (the main office of the

Registrar of Companies is actually in Wales), various decisions have to be taken. The first is as to the type of company. The main types for present purposes are:

- Private company limited by shares
- Public company limited by shares (i.e. a plc)
- Company limited by guarantee

Usually, a spin-out company will be a private company limited by shares. Companies limited by guarantee do not have shareholders and are not usually appropriate for commercial ventures; they are often formed by clubs, charities and other non-commercial institutions. Sometimes spin-out companies are formed as public companies, which involves some additional expense and formality compared with a private company limited by shares. A UK company listed on the London Stock exchange will be a public company, but a public company does not need to be listed. For example, UCL Biomedica plc is a technology transfer company of University College London and is not listed on any stock exchange.

Various documents need to be prepared and lodged at Companies House, and a small fee paid, when incorporating a private company limited by shares. Essentially it is a form-filling exercise, but the company also needs to adopt a Memorandum and Articles of Association. The information that must be provided to Companies House includes:

- The name of the company and the address of its registered office
- The text of the Memorandum and Articles of Association
- Details of the first director(s), company secretary, shareholder(s)
- A statutory declaration made before a solicitor, notary or other commissioner for oaths.

Details on how to form a company can be found on the Companies House website at <http://www.companieshouse.org.uk/about/gbhtml/gbf1.shtml>.

When the author first started in practice, it was conventional to purchase an off-the-shelf company from a company formation agent. One reason for doing this was to save time. The agent had already complied with all the formalities of incorporation and had the company ready and waiting. All that was usually needed to get the company up and running was to change the shareholders



and officers from those initially appointed by the agent, and the name of the company.

In recent years, it has become possible to form a company at short notice (i.e. within a day) subject to payment of an additional fee. In the author's experience, it has become more common for parties or their solicitors to form the company themselves rather than use an agent.

### **Company name**

The name of the company requires some care. It should not, for example:

- be the same as another company name
- be one of the restricted names (e.g. university, institution, patent, pharmaceutical) that require permission of the Secretary of State or others (see further Companies House guidance booklet GBF2: Company Names)
- be too close to another company name or other trading name as this might amount to 'passing off' (a civil wrong for which the aggrieved party would have legal remedies, including damages)
- infringe another person's registered trade mark

Companies House does not object to a proposed company name unless it is identical to another company name (with some limited exceptions) or is a restricted name. The onus is therefore on the party adopting the name to ensure that it does not infringe anyone else's registered trade mark or unregistered rights (i.e. under the law of 'passing off'). Legal advice should be sought on these aspects if required. Some of the techniques for checking that one's name does not infringe anyone else's rights include conducting searches:

- at the UK (and, if the company is to conduct activities overseas, foreign) trade mark registries for registered trade marks (which in the case of UK searches should include pan-European trade marks)
- using internet search engines, and other sources (e.g. UK business telephone directories) to find other uses of the proposed name.

For a search of UK company names see <http://wck2.companieshouse.gov.uk/341c8596ed9bd6fb1a5470e0c4ad2b2c//wcframe?name=accessCompanyInfo>.

For further information on UK trade marks see <http://www.patent.gov.uk/tm/index.htm>

For further, general information on starting a technology company, see <http://www.enterprise.cam.ac.uk/building/building.html>

### **Secrecy orders on directors' home addresses**

If the spin-out company is likely to be involved in medical research or other activities that may attract controversy, directors and the company secretary may wish to apply to the Secretary of State for a certificate allowing Companies House to omit their home addresses from the public register on the company. This procedure is not administered by Companies House and they do not advertise the procedure. Under the Companies (Particulars of Usual Residential Address) (Confidentiality Orders) Regulations 2002, the test that the Secretary of State applies is that the person must demonstrate actual or serious risk of violence or intimidation. Further details may be obtained from:

The Administrator  
PO Box 4082  
CF14 3WE  
Telephone: 0845 303 2400

### **Memorandum and Articles of Association**

The Memorandum of Association sets out the name of the company, its 'objects' – what it has been set up to do – and the amount of the authorised share capital. Many Memoranda have very long lists of objects, usually taken from standard templates. The reasons for these long lists are largely historical (e.g. ancient court cases about whether an action was *ultra vires* (i.e. outside the powers of the company)), and the detailed content of the lists will not usually concern the TTE.

The Articles of Association set out the operational rules of the company, including rights of shareholders, issue and transfer of shares, appointment and powers of directors, etc.

Private companies limited by shares may, but are not required to, adopt a standard form of Articles known as 'Table A'. Table A appears as a schedule to the Companies Act 1985, and has been modified over the years. Some companies' Articles consist simply of a statement that Table A applies, subject to certain, stated exceptions. The main bulk of the Articles then consists of detailed modifications to Table A. Often, though, Table A itself is not included in the document. This can make it difficult to work out what the Articles say on

any particular topic, unless the reader has a copy of the relevant version of Table A to hand.

A company will adopt a form of Mem & Arts when it is incorporated. Where a company formation agent is used, the agent will typically use its standard form documents (which vary in quality – where an agent is used, the authors suggest using a leading name, as they tend to have better quality documentation). Some universities have developed their own standard Mem & Arts, which they may cause the company to adopt once the university becomes a shareholder.

Institutional investors will usually require the company to adopt their preferred form of Articles as a condition of investment. The investor's template Articles will include provisions that protect the investor's interests in such areas as pre-emption rights, sale of shares, decision-making, and so on.

### Share capital

The terminology that is used in relation to shares can sometimes be confusing. Here are a few, brief explanations:

#### *Authorised share capital*

Shares that are available for issue, but may or may not have been issued to shareholders. Shares cannot be issued unless there are enough authorised and un-issued shares available for issue. For example a company might be established with an authorised share capital of 1,000 shares. If 99 shares are issued to Mr Smith, and 1 share is issued to Mr Jones, Mr Smith is for the time being a 99% shareholder. 900 shares remain un-issued. Usually the Board of Directors will be given powers in the Articles of Association to issue further shares in certain circumstances. If the Board decides to issue a further 5,000 shares, it cannot do so until the company has increased its authorised share capital to at least 5,100 shares (allowing for the 100 shares already issued).

<i>Issued share capital</i>	The total number of shares that have been issued to shareholders.
<i>Ordinary and preference shares</i>	Shares can be created in different classes and with different rights attaching to them. Usually the 'default' type of share for most companies is the 'ordinary' share. Investors sometimes require shares that have certain advantages over the shares issued to other shareholders, e.g. in relation to dividends. See further the discussion of minority protection provisions in Appendix C.
<i>Nominal share value</i>	The value of each share as stated, usually, in the Memorandum of Association. Many companies' shares have nominal values of £1 or 1p. The nominal share value is sometimes changed (usually downwards) to facilitate share allocations among multiple shareholders so that they can own precise fractions of the issued share capital. The actual price paid for shares may be more than the nominal share value, e.g. if investors subscribe for shares at a premium to the nominal share value.
<i>Paid up shares</i>	When shares are issued, the shareholder will usually either pay the full nominal price for them (in which case they will be fully paid-up) or will defer payment of some or all of that price. In the latter case, the company can call for the full price to be paid up at a later date, e.g. on winding-up.

### **Directors' duties**

Directors of a company have certain legal duties to act in the best interests of the company. Anyone considering becoming a director should obtain legal advice on these duties. Some law firms produce summary guides on this subject. Becoming a director, particularly of an early stage company whose financial resources may be fragile, is not a responsibility that should be taken on lightly.

The following two points are mentioned because they are sometimes important in relation to spin-out companies, but they are by no means the only important points that a director should consider:

- *Nominee directors.* Some directors are appointed under special powers given to a shareholder (or group of shareholders), rather than being elected by a majority of all the shareholders. For example, it may be a term of the Articles or shareholders agreement that the university has a right to appoint a director for as long as it retains a minimum percentage of the issued share capital of the company. There is a temptation to think that such 'nominee' directors, as they are sometimes called, are appointed to represent the interests of the shareholder who nominated them. However, as a matter of law, all directors have to act in the best interests of the company as a whole, and not just in the interests of any one shareholder.
- *Wrongful trading.* Directors may be personally liable if they allow the company to engage in 'wrongful trading'. See further the discussion of insolvency issues, below.

## Tax issues

### Introduction

The acquisition of shares in spin-out companies, and the subsequent disposal of those shares, creates tax issues for all concerned, including the university, the founding academics, and the investors.

The tax issues for the university may depend partly on whether its shareholding in the spin-out company is held by the university directly or through a university technology transfer company. Tax planning for the university is usually not the direct concern of the TTE; the TTE may need to liaise with the finance director or other responsible officer of the university to ensure that the university's tax interests are protected, or not needlessly prejudiced, by the investment in the spin-out company and the transfer of IP into the spin-out company.

In practice, it may be the tax position of the founding inventors, rather than the university, which affects the way in which the spin-out company is structured, as discussed below.

### **Tax issues for the individual inventor**

Where an employee of a university (usually the academic who created the IP that is being transferred to the spin-out company) acquires shares in a spin-out company, this may create an immediate liability for income tax and national insurance (NI) contributions. Once the university has put IP into the company, the value of the shares is likely to be greater than any price that the academic paid for them. In the worst case, that increase in value may be deemed to be a benefit that the employee has by virtue of his employment, and subject to income tax and NI contributions under the PAYE system at the time the IP is put into the company, even though the value is at this stage theoretical and probably cannot be realised.

This potential problem has been dealt with in a number of ways, including:

- The academic incorporated the company without any assistance from the university, and any transfer of IP by the university to the spin-out company, and investment in the spin-out company, took place at a later date. This seemed to be regarded as acceptable from a tax perspective until the tax rules were tightened up in the last few years.
- Problems arising from the tightening up of the tax rules resulted in discussion between the Inland Revenue and UNICO. This led to the signing of a Memorandum of Understanding between UNICO and the Inland Revenue on the tax treatment of Academics' shareholdings in university "spin-out" companies – 31 March 2004
- After the MOU was signed, the Chancellor of the Exchequer announced changes in the tax treatment of academic shareholdings in spin-out companies, which were implemented by Clauses 21-23 of Finance Act 2005

### **Memorandum of understanding (MOU) with Inland Revenue**

The MOU was finalised following extensive discussions between the Inland Revenue and UNICO. It describes a structure (described in the MOU as a 'safe harbour') for spin-out companies that avoid a tax charge arising for the academic in respect of his or shares in a spin-out company, prior to obtaining a direct financial benefit from those shares.

The structure that was devised is workable, but perhaps more sophisticated than the parties would have chosen in the absence of tax issues. To some

extent the structure has been superseded by changes in the Finance Act 2005, discussed below, but it is still available if companies wish to use it. For example, the Finance Act 2005 does not help the tax position of a manager (e.g. a Chief Executive) who is recruited by the company and given shares in the company, but who was not previously an employee of the university.

The main features of the safe harbour are:

- The academic is issued with convertible preference shares that can be converted into ordinary shares. Detailed rights that may, or may not, be associated with these shares are set out in paragraph 3 of the MOU. For example, the preference shares must not confer the right to a dividend.
- The Articles of Association may contain pre-emption provisions that apply to all shares, and may include 'bad leaver' provisions and 'drag-along' clauses (see discussion of these terms in Appendix C).
- The academic does not have to pay significant tax or National Insurance contributions until he converts his shares into ordinary shares and/or sells them

Any university wanting to take advantage of the MOU should ensure that the provisions of the Articles and shareholders agreement meet the detailed requirements of the MOU.

It remains to be seen whether spin-out companies will bother to use the MOU in future, in light of the changes introduced in the Finance Act 2005, after the MOU was agreed (see below).

### **Clauses 21-23 of Finance Act 2005**

Clauses 21-23 of the Finance Act 2005 introduce a new Chapter 4A to the Income Taxes (Earnings and Pensions) Act 2003 (ITEPA). The aim of these clauses is to remove a tax barrier preventing new spin-out companies. This barrier may be said to have been created, in part, by Part 7 of ITEPA. In very brief summary, the new rules apply where:

- An agreement is made to transfer IP from a university to a spin-out company, after 2 December 2004
- A person [i.e. the academic] acquires shares in the company

- The right or opportunity to acquire them was by reason of employment
- The person is involved in research in relation to the IP

Usually, by putting IP into the company, the market value of the academic's shares would be increased. This could trigger an income tax liability. Where the new rules apply, the market value of the academic's shares (for the purpose of tax calculation) is unaffected by the transfer of IP from the university. The academic is entitled to opt-out from this relief, though, and take the tax hit at this stage, which in some situations might be preferable.

In practice, by applying the new rules, it should be possible to avoid issuing the academic with convertible preference shares as described in the MOU and instead issue ordinary shares.

For further information on tax aspects, please consult your tax advisers. See also the Inland Revenue guidance at <http://www.hmrc.gov.uk/manuals/ersmmanual/ERSM100010.htm>

### **Royalty obligations in assignments: binding on a subsequent owner of the IP?**

A disadvantage of assigning, rather than licensing, IP to a spin-out company, is that the company can usually assign on the IP to someone else (the new owner) and the new owner may not be bound by any obligations in the original assignment (e.g. to pay royalties).

For this reason, historically an author was always well-advised to license his copyright to a publisher rather than assign it. A number of reported court decisions make this point forcefully (e.g. see *Barker v Stickney* [1919] 1 KB 121, CA).

In cases where the spin-out company has continuing obligations to the university with respect to the IP (e.g. royalty or exploitation obligations), the authors' view is that there should be a very strong preference for structuring the transaction as a licence and not as an assignment. There are also arguments for having a licence where there are no such continuing obligations.

Different legal theories have been put forward to make obligations in an IP assignment binding on a subsequent owner of the IP, but all of them are, to



some extent, speculative in the absence of a body of authoritative case law. These theories include 'vendor's lien' – a kind of charge over the assets being sold – and a principle known as 'benefit and burden' – in other words the benefit of the assignment can only be taken if the burden, or obligations under the assignment, is also taken. There is insufficient space here to discuss these various theories or the reported court cases in which they have been discussed; in the authors' view, none of them has yet become settled law. The most attractive legal solution may be that of conditional assignments. According to a leading Chancery judge of the 20th century, Vice Chancellor Megarry, in *Tito v Waddell (no 2)* [1977] Ch 107, it should be possible, in principle to execute an assignment of IP that is conditional upon the payment of royalties etc, albeit this is rarely done. In other words, the obligations to the university are not just contractual obligations, they are 'attached to' the assignment. There can be no guarantee that an English court would follow Megarry's line of reasoning, and in any event very clear wording would probably be needed to achieve such a conditional assignment.

This is a highly specialist issue on which legal advice should be sought, if required.

## Dealing with insolvent spin-outs

### Wrongful trading

Directors of a company may face personal liability for 'wrongful trading' if the company has gone into insolvent liquidation and, at any time prior to the liquidation, the directors knew or ought to have known that there was no reasonable prospect of avoiding an insolvent liquidation. Directors should be aware of their duties in this field (some law firms have produced guidance notes for their clients) and the directors should probably take legal advice if they think that such a situation has arisen. Resigning as a director once such a situation has arisen may not absolve the director from liability.

### Recovering 'our' IP from the spin-out company

Where a university has licensed or assigned IP to a spin-out company, it may wish to try to recover that IP from the company if the company becomes insolvent.

Where the IP is licensed to the company, the licence agreement should include a provision allowing the university to terminate the licence upon defined events of insolvency.

Where the IP has been assigned to the company, recovery of the IP may be more problematic. The original IP agreement may include a provision stating that, upon insolvency, the company must re-assign the IP to the university. But such a provision may not work, because:

- the company may refuse to execute an assignment, and/or
- liquidators have certain statutory powers to avoid contractual obligations.

The following paragraphs briefly discuss some possible techniques to try to achieve a recovery of the IP. In the authors' view there is no easy, perfect solution, other than to refuse to assign the IP to the spin-out company in the first place.

The possible techniques include the following:

- (1) *Assignment to trustee.* If an assignment is required, rather than a licence, the university could assign the IP to a trustee who would hold the IP on trust for the spin-out company as long as it remained solvent. Upon any insolvency, the trustee would hold the IP on trust for the university or its nominee. This approach may be perceived as being too theoretical and complicated, and too big a step from current practice.
- (2) *Assignment to spin-out.* Assign the IP to the spin-out company, but include a contractual obligation on the spin-out to reassign to the university in the event of insolvency. A disadvantage of this approach is that the liquidator may reject the obligation to re-assign as onerous (e.g. because the re-assignment is not at full market value). Possible ways of tackling this problem include:
  - (a) Provide that the re-assignment will be on full market terms. This may not be attractive to the university. And how will the full market terms be determined?
  - (b) Instead of an automatic re-assignment, there could be an option or right of first refusal to negotiate a reassignment at full market terms. An option mechanism may facilitate the determination of market terms (e.g. the

terms would be negotiated or could go to an independent third party to settle them), but may still be commercially unattractive to the university.

- (c) To require a re-assignment before the appointment of a liquidator or other insolvency official. This may potentially avoid the right to reject contracts under insolvency legislation, but may be commercially unacceptable. For example, the university may find itself in the position of 'pulling the plug' on the company, i.e. triggering an insolvency, if it exercises any such rights.
  - (d) To include power of attorney in favour of university to enable it to "perfect" the assignment back, i.e. by signing the assignment on behalf of the spin-out company. The authors have seen IP agreements that have included such a mechanism, but the legal effect of any such provision may be uncertain, as it could be viewed as an unlawful attempt to get around insolvency legislation.
  - (e) To include a prohibition on the company assigning the IP without the university's consent. This may not be commercially acceptable to the company, and a liquidator might seek to reject it.
- [3] *Qualified assignment* to spin-out company. Instead of giving an absolute assignment of the IP to the spin-out company, the university might consider a qualified form of assignment, e.g.:
- (a) Assign subject to a fixed charge over the IP in favour of the university, which would be registered at Companies House and Patent Offices. The charge would probably not enable the university to recover the IP as such, but could be structured so as to impose royalty obligations etc on any new owner of the IP. The creation of a charge over non-registered IP (e.g. copyright) is problematic; this route may be more suited to patents.
  - (b) As an alternative to registering a charge, the assignment could be stated to be *conditional* upon performance of certain stated obligations (e.g. to pay royalties). See the discussion of royalty obligations in assignments, above. As discussed there, this is a somewhat theoretical solution.
- [4] *Pragmatic solution*. Instead of trying to bolster the university's position through use of any of the techniques described above, some universities may prefer simply to make a bid for the IP, at 'market rates' if and when any insolvency arises and if the university still wants the IP at that time.

With most of these approaches, there are two distinct considerations:

- What works as a matter of law; and
- What will assist the university in negotiations with a liquidator

If the liquidator proves uncooperative, it may not be cost-effective for the university to pursue legal remedies through court action. Any contractual solution should bear these points in mind.

Ultimately, the simplest solution (if simplicity is the objective) may be either:

- Not to assign the IP, and to retain a right to terminate any licence on insolvency, or
- To accept that, following assignment to the company, the university is not going to retain control of the IP.

# Acknowledgements

Special thanks are due to the UNICO members who commented (including by participating in a lengthy teleconference) on various issues that are covered in this Practical Guide.

In addition, the authors would like to thank the following people for discussing various points with the authors and (in some cases) commenting on an early draft of this Practical Guide. Any errors which remain are, of course, the responsibility of the authors.

- Stephen Brett and Emma Wheatley of Isis Innovations' legal department
- Rosemary Boyle, Legal Services Office, and Miranda Weston Smith, Cambridge Enterprise, both of Cambridge University
- Jeff Skinner, University College London
- Tony Hickson, Head of Bioscience Team, Imperial Innovations Limited

UNICO is based on, and thrives upon, the sharing of ideas within the profession. We believe that the UNICO Practical Guides are the latest tangible example of this. We thank everyone who has contributed to them, and we thank you for taking the time to read and use them.



St John's Innovation Centre

Cambridge CB4 0WS

T: 01223 422098

[www.unico.org.uk](http://www.unico.org.uk)