UNIVERSITY OF LIVERPOOL

The University of Liverpool Spin-out Companies – Guidelines and Procedures 2024

University of Liverpool Enterprise
Research, Partnerships and Innovation

https://staff.liverpool.ac.uk/research/ip-commercialisation/

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Spin-Out Companies – Guidelines & Procedures

Introduction

The University encourages its academic and research staff to form new spin-out companies with the involvement and support of the University of Liverpool Enterprise Team (previously known as the IP Commercialisation Team) and in line with the following procedures.

Spinout companies are encouraged by the University as they can create socio-economic impact. If they are successfully nurtured and scaled, they can add significant value to the local innovation ecosystem.

A spin-out is a new company that often involves the participation of University of Liverpool staff (academic and research staff) and the use of intellectual property owned by University of Liverpool.

The University expects to be a shareholder in spin-out companies and recognises that University staff are also likely to expect to become shareholders.

The procedures for University staff becoming involved in companies other than spin-out companies through consultancies, advisory roles, or directorships are described elsewhere eg. the Consultancy Policy, Conflict of Interest Policy.

Role of the Enterprise Team

The Enterprise Team is part of the Research, Partnerships and Innovation Directorate within the University. The Team will support the spin-out team in developing and establishing the new spin-out company, licensing the intellectual property into the new spin-out company, seeking necessary University permissions for the formation of the new spin-out company and putting forward requests for investment into the spin-out company.

These arrangements relate to new companies where at least one of the founding team is remaining as a member of staff at the University.

If all the University staff involved are leaving the University to join a new company, then these arrangements may not apply and the University may prefer to treat the company at an arm's length basis as a wholly independent company.

If all those involved in the company are students and not staff at the University, then these arrangements may not apply except where the company needs access to University-owned intellectual property. Student start-up companies are currently supported via the Careers and Employability Service.

Approval by the University

The spin-out team will be supported by the Enterprise Team and the overall arrangements relating to shareholdings, intellectual property licensing and University staff involvement will be approved by the Head of the Enterprise Team and the University's Enterprise Board. The line managers for the spin-out team will also be involved in approvals, for example, Heads of Department.

The Enterprise Team uses a two-stage approval process.

- The first stage involves the completion of an outline description of proposed business by the spin-out team and sometimes approval in principle to spin-out from the Enterprise Board. The overall purpose at this stage is to recognise the intent of the spin-out team to form the company and to ensure all those involved are informed of the plans. At this stage the University stakeholders are being asked to confirm awareness and support of the plans, rather than giving formal approval to proceed. This process provides the opportunity to identify any issues for the spin-out team to address.
- The second stage involves documenting details of the arrangements which have been agreed by all stakeholders for shareholdings and intellectual property licensing. The Team will then request approval from the University for the spin-out to proceed. This process will also cover other aspects that are important in setting up a spin-out company - such as the management team, business plan, business model, lead customers etc.

The Enterprise Board has the final approval authority for the University and the Board will approve or indicate any conditions or objections to the proposed spin-out company via the Head of the Enterprise Team.

Shareholdings

The founding shareholders of the company are likely to be (i) the University staff involved in the underpinning research and creating the business opportunity, and (ii) the University; followed by (iii) external management. Sometimes there will be financial investors involved at the outset, who will subscribe for founding shares.

The University has a standardised approach, described below, for determining the relative shareholdings between (i) the University staff involved in the underpinning research, and (ii) the University.

Future shareholdings obtained by (iii) financial investors and (iv) external management are a matter for negotiation with the company.

In some cases, external research funders expect to become shareholders in spin-out companies which use intellectual property developed under research arrangements where they have provided funding. This will be identified as part of the Invention Disclosure Form completed by the University staff with the Enterprise Team. Where this is the case, the allocation of shares between the University and the staff involved in the underpinning research will be adjusted i.e. Usually, all parties will dilute equally to accommodate the external stakeholder. Dilution of shares occurs when a company issues additional shares of stock, diluting existing shareholders' percentages of ownership in the company.

The University expects to be a shareholder in the spin-out for the following reasons, in recognition of its contribution, for example, in one or more of the areas highlighted below:

i. The University has provided the environment and facilities in which the underpinning research has been developed.
ii. The intellectual property may have been developed with support from grant funding bodies, either from public or charitable sources.
iii. The University is providing the support of the Enterprise Team and its other administration teams (e.g. Legal, HR) and networks in establishing the new company.
iv. The University is giving its permission for its staff to participate in an external business venture.

The 'Liverpool model' is set at 20% founding equity to the University, which is fixed and independent of the level of University support given to the spin-out project team, pre-startup. The University's founding equity is fully diluted until the first round of external investment. In this context 'fully diluted' means that the individual founders' 80% includes:

i. Mandatory 20% option pool (established prior to the first external round of funding);
ii. Allocation of shares to the management team; and
iii. Equity allotted as part of an incubator/accelerator programme, or other means of support which is available prior to an external funding round (e.g. Start Codon, LYVA Labs etc.)

In taking this approach the University is recognising that the University founding staff are due a substantial stake in the spin-out company because they have made an intellectual contribution to the underpinning research; they are committing to invest a substantial amount of effort in developing the business venture; and the business effort will require their full support and commitment.

However, not all inventors or contributors to the intellectual property will be founders, and it is important that the people who are key to the company's success are appropriately incentivised via equity (see non-founding inventor section below). The University will facilitate the discussions around equity between founders and non-founders, and will ratify the company structure. If the founders cannot agree, or if the share structure is perceived to be outside market norms and investor preferences, the University may veto the proposed structure.

Founding shares are subject to provisions called 'reverse vesting' which means if a founder leaves the company within a certain period of time (usually 3-4 years), or under circumstances which could potentially cause difficulties for the company, their shares or some of their shares may revert back to the other founding shareholders.

The University recognises that following formation, the company may enter into arrangements with University staff such that the University staff acquire further shares in the company (beyond any taken up through pre-emption rights i.e. investing their own personal cash as an investment).

All University staff members involved are responsible for ensuring that there are no unreported conflicts of interest with these arrangements. If in doubt as to whether you have a conflict of interest, please talk to the Enterprise Team.

Any variations to the 80:20 model must be reviewed by the Pro-Vice Chancellor for Research and Impact, and if necessary discussed with the Enterprise Board. External advice may be sought to ensure the company structure is in line with market expectations. University staff agree the decision of the Enterprise Board is final, and there can be no further appeal through the University disputes procedures. The Pro-Vice Chancellor for Research and Impact and the Enterprise Board will consider the arguments based on the four sets of reasons above.

The 80:20 model will apply in nearly all cases. Scenarios which may require the model to be flexed are likely to include the following: companies involving more than one institutional shareholder, joint ventures, or spin-in companies. The University will also consider a 10% pre-money, fully diluted shareholding in very limited circumstances, and only where the founding team can provide evidence that all of the following circumstances apply: 1) there is no 'hard IP' (inventions or patents) and there is no University-owned identifiable 'soft IP' (this includes software, algorithms, copyright and other unregistered IP, such as 'know-how', databases, animal models and data); and 2) where no University funding has been used to support the opportunity (either direct support via the University and/or its infrastructure, including support for PhDs via the relevant School, and/or through devolved funding schemes which the University has used to support a project); and 3) the new spin-out company is not engaging with existing University customers or collaborators, thereby diverting consultancy, collaborative or contract research revenue which would have been available to the University.

Licensing of University Intellectual Property

One of the commonly observed features of a spin-out company is that it uses intellectual property (IP) owned by the University and which is licensed in to the company. This IP may be in the form of granted patents or patent applications, copyright, know-how and data. See the University's **IP Policy** for information regarding ownership of IP generated by members of staff and students.

Assignment - the University does not immediately assign i.e. transfer ownership of its intellectual property into the new spin-out company due to the inevitable risks associated with a new start-up company. However, the University will generally agree a mechanism for assignment, based on performance milestones.

Licence terms - the licence terms will be negotiated between the Enterprise Team and the new company representative or management team.

The University recognises its position as a shareholder in the spin-out company and licenses its IP into the company on terms which take into account the challenges facing the company in its early years.

Licence terms are negotiated on a case-by-case basis, but the University seeks to apply commercially reasonable terms, particularly when the company is in its start-up phase. The University acknowledges that extracting royalties at an early stage in the company's development is not investor or founder-friendly, however the University may require royalties to be payable under a license to, for example, a therapeutic, because of the significant dilution of equity and potential revenue from these types of inventions.

Instead of running royalties (payments to the owner of the IP, usually based on a percentage of sales of products or services using the IP), in most cases the licence agreement will include arrangements such as milestone fees, assignment fees and exit fees, representing accumulated royalties. The exit fee will be within a range of 1%-2% of the sale price of the company, depending on the sector and likelihood of dilution, and is intended to balance the reasonable licensing terms and low founding equity position taken by the University.

Patent costs - Patent cost support for intellectual property which has been licensed into the company can be requested by the spin-out company for up to 2 years from the date of the licence, and subject to an agreed annual cap. Unless recovered under the licence agreement, these costs may be converted to equity.

Non-founding inventors - the academic founders and management team will need to discuss with the Enterprise Team as to whether the non-founding inventors will be recognised via founding shares, or via a royalty-bearing licence arrangement (from which the University will receive and distribute royalties to the non-founding inventors). If a royalty-bearing licence is the preferred option, the University will reduce the royalties pro-rata, so it is not perceived to be 'double-dipping' with respect to its equity allocation and assignment/exit fee. Non-equity holding academic inventors will benefit from any royalties and milestones relating to the IP, but will not usually benefit from any negotiated assignment fee or exit fee.

Non-founding IP - Sometimes the company's management team will ask for access to future IP which is developed by the academic founders within the University, but which has not been funded by the company. If agreed, access will be time-limited, ring-fenced to a specific research group and granted on a royalty-bearing basis. The University will generally require a development plan from the company, and expect that it can demonstrate its ability to develop or add value to the new intellectual property. In some cases, the new intellectual property will not be usable without access to the founding intellectual property. However, in any case, the royalty-bearing licence is intended to reward inventors of the new intellectual property who do not have shares in the company, via a share of revenue/royalties received from the new intellectual property.

Directorships

The University recognises that its staff may become Directors of the new spin-out company.

The University encourages its staff to undertake training in how to be an effective company director and the responsibilities and liabilities of being a company director. The University encourages its staff to obtain appropriate director insurance from the new company. The University takes no responsibility for the consequences of its staff becoming directors of a spin-out company.

Consultancies

The University recognises that the spin-out company may wish to engage University staff as consultants to the company on a consultancy fee basis, or via a buy-out of time from the University.

The University recognises that consideration for these consulting services may be in cash or further shares and share options.

The University requires its staff to use the University's normal procedures for arranging any consulting contracts where the staff are being personally remunerated. See **www.liverpool.ac.uk/intranet/consultancy/**

Part-time Working

University staff may wish to change their employment arrangements with the University, for example, to work part-time for the University and part-time for the new spin-out company. Where this is the case, individuals should discuss these arrangements with their Head of Department and any associated agreement will be signed off by the University HR team.

Similarly, University staff may wish to stay fully employed by the University and for the spin-out company to contract with the University for the individual to allocate a proportion of their time to research projects directed by the company (via a secondment agreement). Where this is the case, individuals should speak with their Head of Department and the Enterprise Team.

Support for staff costs may be requested by the company for a period of up to 2 years, or until the company has secured sufficient private equity investment or has the cash to pay the costs, whichever is the shorter.

Underwriting of the costs of a sabbatical or secondment into the spin-out company at no charge, or a significantly reduced charge for a period of up to 2 years may be agreed, in return for equity allotted to the University and subject to agreement by the Head of School. The value of the equity shall be based on a fully costed basis and recognised by the company either via a convertible loan or if there is an agreed company value, then a fixed capital amount of shares (one-off) shall be allotted on company formation to reflect e.g. 2 years discounted at the prevailing value.

University Directorships

The University wishes to support the development of its spin-out companies and provide appropriate advice to the company.

The University requires the right to appoint a Director to the Board of the company whilst it owns at least 10% shareholding in the company. The University may appoint an observer to the Board in place of Director if it wishes.

The University will also require 'Information Rights' such that it receives copies of board papers whilst it is a shareholder.

Access to University Facilities & Premises

The University recognises that the new spin-out may wish to use University facilities and to develop its business activities from premises owned or controlled by the University.

The University has access to many large-scale facilities which the new company will not be able to acquire on its own. In some cases, the University is not free to use these facilities as it wishes and consents are required from third parties. In its early stages, the new company may wish to operate from University premises. Where this is the case, the company will discuss appropriate arrangements with representatives of the University. This will involve the Head of Department and other appropriate University representatives.

Access to facilities should be identified early on, so that the appropriate arrangements can be discussed and put in place.

Access to facilities may be requested for a period of up to 2 years, or until the company has secured sufficient private equity investment. Access to University facilities at no charge, or at a significantly reduced charge for a period of up to 2 years may be agreed, in return for equity allotted to the University. This is subject to agreement by the Head of School. The value of the equity shall be based on a fully costed basis and recognised by the company either via a convertible loan or if there is an agreed company value, then a fixed capital amount of shares (one-off) shall be allotted at on company formation to reflect e.g. 2 years discounted at the prevailing value.

Enterprise Investment Fund

The University Enterprise Investment Fund can make awards to accelerate the formation of spin-out companies. For information on how to apply for Enterprise Investment Fund Awards, see **www.liverpool.ac.uk/intranet/intellectual-property/enterprise-investment-fund/.**

Enterprise Investment Funding (EIF) start-up capital investment of up to £50k can be requested as a funding support package, where there is no founder cash investment, external investment or grant funding available at the point of spinning out. This is intended to support the spin-out with its own Board formation, legal and other costs for company setup, along with cash flow in the short term and payment of patent costs. It is not usually intended to support salary costs for staff moving into the new spin-out company.

Where an EIF funding package is agreed, it will be made available on the University's standard convertible loan terms, subject to Enterprise Board approvals and details from the company outlining the use of EIF funds.

Conflicts of Interest

Involvement in a spin-out company can involve conflicts of interest arising between the interests of the company, the interests of the University staff involved and the interests of the University. Conflicts may arise in the following areas:

- Disclosure of IP
- Research funding relationships
- Involvement of student projects in company activities

The University has a Conflict of Interest Policy explaining procedures for managing Conflicts of Interests, see **www.liverpool.ac.uk/research-integrity/conflicts-of-interest**

The foundations of the University's approach are for individuals to identify and report potential conflicts and for all those involved to seek effective ways to manage the conflict such that the risks arising from the conflict are minimised. In some cases resolution may not be possible and the University may not allow certain activities to proceed.

Disputes

Any disputes relating to these arrangements will be considered under the University's Disputes Procedure, see **https://staff.liverpool.ac.uk/media/livacuk/collaborate/Intellectual,Property,Policy.pdf**

University Shareholder Management

The University owns shares in a number of spin-out companies. The shareholdings are assets of the University and the University Chief Financial Officer has overall responsibility for managing the shareholdings.

The University manages its shareholdings as follows, identifying two categories of shareholding:

University Founding Shares – acquired at the start of the company, for the same low subscription price as the University staff acquire their founder shares, or Enterprise Investment Fund shares, when the University's Enterprise Investment Fund has made awards that support the formation of the spin-out company and / or pre spin-out activities.

Investor shares – acquired by the University as part of an investment finance round by the company. The University will pay the same price as other investors at this stage.

The University may buy shares in the company as an investor at early or later stages. The University's founding and Enterprise Investment Fund shares will carry pre-emption rights which enable the University to buy more shares in future investment rounds.

The University may retain the right to transfer its pre-emption rights to investors with which it has a close relationship. If this is the case, a discussion will take place with the founders prior to spinning out.

Dividends

The University may require a dividend policy to be put in place at the time of company incorporation. Dividends allow shareholders to benefit from any profits a company makes, prior to a share sale. This issue will be considered on a case by case basis.

Decisions to sell

The University alone is responsible for taking decisions about when to sell its shares in spin-out companies (subject to commercial lock-in agreements).

These decisions are taken by the University Finance Director after consultation with the Enterprise Board.

Distribution of proceeds

Proceeds from the University's shareholdings in spin-outs from both dividends and the sale of shares will be distributed within the University, after recovery of any investments made from the Enterprise Investment Fund, as follows:

University Founding Shares

University Centrally	70%
Host School/Institute(s)	30%

Where more than one University School/Institute is involved the respective Heads of School/Institute will agree the arrangements. Where a restructure takes place, resulting in a change in School/Institute, the income will be allocated to the School/Institute that is most closely related to the original School/Institute.

Where the equity realisation is significant the University will cap the distribution of proceeds to the University School/Institute at £500,000, unless otherwise agreed at the point of receipt of income. Any income which is distributed to the School/Institute will be subject to the University's normal budgeting and financial planning processes.

The University may consider using the proceeds of the sale of shares acquired via Enterprise Investment Fund in order to stimulate further enterprise, or entrepreneurship activities. Further information on the Enterprise Investment Fund can be found here **www.liverpool.ac.uk/intranet/intellectual-property/enterprise-investment-fund/.**

Investor shares

Proceeds from the sale of investor shares are for the University Centrally.

University staff do not receive a share of these proceeds as they may be beneficiaries from their own personal shareholdings or under the University's intellectual property licence revenue distribution arrangements with respect to founding IP.

Glossary

Assignment – The transfer of ownership of intellectual property between one person or organisation to another. This includes patents, trade marks or designs and needs to be completed in writing.

Assignment fee – An amount payable by the assignee (the person receiving ownership of the intellectual property rights) on assignment.

Convertible loan – A loan offered by a funder that can be converted into company shares. They can be offered ahead of funding rounds as a rapid financing option.

Dilution of shares – this occurs when a company issues additional shares of stock, diluting existing shareholders' percentages of ownership in the company.

Double-dipping – When a founder with shares also receives income from a technology licence agreement, essentially being rewarded twice for the same activity.

Founding equity – the amount of shares owned by the founders of a company.

Intellectual Property (IP) – the results and outcomes of research which can be legally protected. Includes patents, trade marks, software, algorithms, copyright and other unregistered IP, such as 'know-how', databases, animal models and data.

Mandatory option pool – a portion of company shares set aside to issue to employees, directors and advisors that can be used to incentivise and/or reward.

Non-founding IP – Intellectual property that is developed by academic founders within the University but not through funding from the spin-out company.

Pre-money, fully diluted shareholding – The total shares of a company, including any agreed option pool prior to outside investment (pre-money).

Royalties – A payment made by another party to the owner of intellectual property for its use.

Royalty-bearing licence – A licence to use intellectual property in return for a fee, which can be a fixed rate or a percentage of a product developed from the intellectual property.

Spin-out company - A spin-out company is a new company that involves the participation of University of Liverpool staff (academic and research staff) and the use of intellectual property owned by University of Liverpool.