

MEMORANDUM
NATIONAL INSTITUTE FOR STRATEGIC TECHNOLOGY
ACQUISITION AND COMMERCIALIZATION (NISTAC)

20 March 2009

From: Ron Sampson, Secretary

To: Kent Glasscock, President and Chief Executive Officer

Copy to: Ron Trewyn, Chair, Board of Directors

Subject: 2005-6 Legal Review of NISTAC Structure and Operations

This responds to your request for an analysis of the status of implementation of the recommendations arising from the 2005-6 legal review of NISTAC and its structures and operations by Wildman Harrold. Many, but not all of the findings and recommendations arising to that review were cited within a 2006 memorandum from the legal firm. Of course, that memorandum was classified as "Privileged and Confidential, subject to the Attorney-Client and Work-Product Privileges", and continues to be managed in that framework.

Overview: Overall, the recommended actions arising from the legal review appear to have been fully implemented. In this regard, it should be noted that some recommendations involved the retention of then existing structures and/or procedures, and others involved modifications. Of course, following the principles of "best practices" is a continuing process that requires continued awareness, renewal and diligence. Occasional reviews like this should be helpful to sustain awareness and best practices compliance.

Background: The legal review focused on the structure and operations of the NISTAC group of companies, including the wholly-owned, for-profit, management services subsidiary company, Mid-America Technology Management, Inc. (MTM) and the for-profit, investment holdings company, Manhattan Holdings, LLC (MHL). Since all the institutional sponsors of the three companies were governmental or not-for-profit entities, consideration was given to other approaches, particularly including consolidation of all three companies and their operations into one – within NISTAC itself. Of course, staff compensation policies and procedures also were an important focus for review.

Findings: With due consideration to many factors, particularly the opinions of the Internal Revenue Service, the legal review concluded that the existing organizational structure of three affiliated companies remains most appropriate. It not only enables proper separation of not-for-profit activities and finances from for-profit ones, but also provides additional insulation of the sponsoring institutions from the risks and liabilities associated with technology transfer and commercialization support functions. This is particularly true when technologies are commercialized through the creation and nurturing of startup or new venture companies, since such entities inherently are high risk undertakings.

A summary of other key findings and recommendations arising from the legal review, along with the current status of each, follows.

1. Board Structures. To preserve the independence and autonomy of MTM from NISTAC, *a majority of MTM's Board of Directors should be independent from NISTAC's Board, and the NISTAC Executive Committee should have a super-majority of non-MTM Board members.* This recommendation was fully implemented. Specifically, MTM's Board of Directors consists of five members, with only one MTM Director also serving on the NISTAC Board – to facilitate communications between the Boards. The dual Board role customarily is served by the Chair of the NISTAC Board of Directors, but the MTM Board is chaired by a different person, who is not a member of the NISTAC Board. The NISTAC Executive Committee (EC) normally has at least five members and only one NISTAC EC member also serves on the MTM Board (again, normally the NISTAC Board Chair). A similar separation is maintained in MHL, with investment decisions made by an Investment Committee comprised of representatives of the three institutional investors in that limited liability company. The three institutional Members themselves effectively constitute the oversight board for the manager of the fund, MTM, with MHL operations essentially limited to making and monitoring investments.
2. Corporate Operations and Finances. *The operations of the corporations and their funds should be separated.* This always has characterized the three companies. The Boards have separate meetings, and maintain separate corporate records and financial accounts. The financial accounts of each company are subjected to separate, independent annual audits. Any inter-company financial transactions, for example under the services agreement between NISTAC and MTM, are approved by the Boards of each company during the budgeting process and financial reports are provided to the Boards on a periodic basis. In this regard, it should be noted that MTM receives a minor portion of “carried interest” in the investments made as compensation for its services to MHL. However, that interest is subordinated to return of the original investments to each of the institutional investors, and this ensures that MTM truly is only compensated if the fund is successful. This of course remains work-in-progress, and to date MTM or its staff have not received any compensation from MHL.
3. Corporate Roles. *Not-for-profit services, such as licensing patents on behalf of the university and its research foundation, need to be clearly separated from for-profit services, such as providing support to portfolio companies.* This need defines the core basis for the two company structure of NISTAC and MTM and the staffing arrangements between them. Such arrangements are transparent to the Internal Revenue Service, which has specifically validated such approaches for other institutions in the past. Nonetheless, this is an area that requires continuous diligence since the same staff people deliver both functions.
4. Compensation. *Compensation for employees of both MTM and NISTAC must be reasonable.* In this regard, compensation is all inclusive of base salary and any bonus or incentive compensation, including equity interests. Of course, the concept of reasonableness is much more rigorous for not-for-profit entities, than for-profit ones. Collectively, several elements establish the presumption of reasonable compensation for not-for-profit entities that are exempt from taxation.
 - a. Authorized Body. *Compensation arrangement must be approved in advance by an “authorized body” which is comprised entirely of individuals who do not have a*

conflict of interest with respect to the compensation arrangement. The NISTAC Bylaws establish the Compensation Subcommittee (CSC) of the Executive Committee to review and make recommendations on compensation of senior NISTAC Executives, particularly the President and Chief Executive Officer. The CSC is comprised of members of the NISTAC Board of Directors, who generally are drawn from the private sector, and who perform their duties as a public service, that is, without personal compensation from either NISTAC or MTM. On at least an annual basis, the CSC reviews and makes recommendations for the compensation of key officers of NISTAC to the MTM Board of Directors, who make the final determinations of compensation. Of course, under the design and intent of the existing structure, all staff of NISTAC are actually employed by MTM, and these people are considered as “leased employees” for NISTAC. Accordingly, the CSC has considerable influence given its empowerment from the Executive Committee of the parent company, that is, sole shareholder of MTM. Notably, the members of the CSC and the MTM Board each meet the standards required to avoid “conflicts of interest” for such matters, according to U.S. Department of the Treasury Regulations.

- b. Comparability. *The authorized bodies must rely upon comparability standards and other data to set the amount of compensation.* This is accomplished in three primary ways.
- i. On occasion as determined by the CSC and/or MTM Board, an outside independent consulting firm is commissioned to benchmark the compensation for the President, and possibly other key officers. Importantly, no officer who is a subject for the study, including the President, is involved in selecting the consulting firm, and in commissioning or overseeing the study. Such benchmarking studies are based upon national data compiled from a variety of sources, and the last such study was completed in September 2008 under the auspices of the CSC. The data from such studies is presented to the CSC and MTM Boards for consideration in their annual review of compensation.
 - ii. The private sector expertise and experience of the members of the CSC and MTM Board are utilized to calibrate compensation standards, particularly within the region. Historically, this calibration has defined what has been commonly called “the Manhattan discount,” wherein the same job in Manhattan appears to command lower compensation than it would elsewhere.
 - iii. Data from other relevant enterprises is also considered. This particularly includes the compensation for similar jobs elsewhere within the KTEC network, and also draws upon such national sources as the annual reports of national surveys by the Association of University Technology Managers (AUTM).
- c. Documentation. *The basis for determination of compensation must be adequately documented.* A defined, thorough, and methodical approach is used to determine individual compensation for the President and other key staff on an annual basis. The process for the President and/or Chief Executive Officer is led by the CSC in concert with the MTM Board. The process involves a written review of both corporate and personal performance, with achievement of annually pre-determined goals being

quantified. This provides a basis for determining both bonus and adjustments in base compensation. Written records of the performance reviews, minutes of the proceedings, and determinations are maintained, with the Chair of the MTM Board certifying any authorized payments for the President in writing. Typically, the President manages a similar process for other direct staff reports, and summarizes the outcomes of these for the CSC and MTM Board. Any plans, policies or procedures for compensating other staff are reviewed and subject to approval by the CSC and MTM Board.

- d. Incentive Compensation. *Incentive compensation must be capped and approved in advance.* Bonus compensation generally is capped at 25% of base salary or less, and that cap historically has not been reached in the context of annual reviews. (Goals are set high enough to ensure 100% goal achievement is not within easy reach.) Where relevant to the job role, incentive compensation may also involve some sharing of a minor portion of equity or royalty income derived from services of either or both NISTAC and MTM. In cases wherein such compensation arises from services or intellectual property licensing by NISTAC, limits are placed on the maximum value of any payment to an individual relative to the annual base salary for that individual. These limits are defined in policies approved by the CSC and MTM Board, and are intended to meet IRS standards. Specific payments under the approved policies also must be authorized in advance by the CSC and MTM Board. In any event, only a minor (less than one-third) portion of that received by NISTAC or MTM are authorized for allocation amongst contributing staff according to their performance contributions. Any distributions or payments of course constitute taxable events for the recipient based upon the value at the time of payment.
- e. Licensing Guidelines. *It might be appropriate to set general policy parameters for acceptable allocations of equity versus licensing fees that NISTAC can accept to avoid potential conflicts between staff incentive interests and those of the licensor.* Such guidelines for specific allocations are deemed impracticable because each license deal is very case-specific, that is, nearly unique. However, sufficient safeguards and guidelines are in place to ensure the interests of the licensor are paramount. Specifically, cash payments in terms of up-front license fees and on-going royalties always are preferred. However, in special cases wherein the licensee has limited cash availability (such as a start-up company created to commercialize a specific technology), equity may be accepted in lieu of cash. The terms for such follow industry norms and valuations, and are subject to approval by both the NISTAC Chair and President. At the present time, the Chair has particular responsibilities and expertise related to licensing of university technologies and a sole focus on ensuring institutional interests are paramount. In the event, that the Chair and President are not in agreement, the matter will be referred to the NISTAC Executive Committee for resolution.

In summary, the 2005-6 legal review was intended to provide an update on the appropriateness of the structures, policies and procedures established a decade earlier under the aegis of KTEC and its counsel. The purpose was to help ensure NISTAC and its affiliates were operating under the current “best practices”, particularly in view of any regulatory or precedent changes that might have occurred since 1995. Importantly, the review found the fundamental multi-company

structure was appropriate and sound. However, there were identified opportunities for improvements, and each of the related recommendations was implemented. Nonetheless, all recognize the vital importance of maintaining an accountable, productive and transparent organization, which is a source of pride, not embarrassment to its institutional sponsors and non-compensated Board members. This means the process of continuous improvement and constant monitoring never ends, but the systems in place provide a basis for confidence that these needs will be met.

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