



M E M O R A N D U M

TO: MEMBERS OF THE INDEPENDENT CITIZENS' OVERSIGHT COMMITTEE

FROM: ELONA BAUM, GENERAL COUNSEL

SUBJECT: CONSIDERATION OF INTERIM REGULATIONS IMPEMENTING THE MULTIPLE PAYBACK RISK BASED PREMIUM APPROVED BY THE ICOC IN LIEU OF WARRANTS

DATE: JANUARY 20, 2011

On December 8, 2010, the ICOC approved in concept for a one year trial period, a risk premium multiple payback option that Loan Recipients could elect in lieu of providing warrants under the Loan Administration Policy. Attached is the memorandum which described this payback alternative and a proposed regulation implementing this program.

The salient aspects of this proposed regulation are as follows:

- Loan Recipients of Product Backed Loans would pay up to five (5) times the amount of principal if certain revenue milestones were met.
- Loan Recipients of Company Backed Loans would pay up to three (3) times the amount of principal if certain revenue milestones were met.
- CIRM would issue an advisory letter and term sheet prior to submission by the Loan Recipient of its application in response to a Request for Application. The advisory letter and term sheet would identify which revenue streams are subject to the risk premium payment triggers.



- Risk premium payments would be made in four equal quarterly installments beginning at the end of the initial term of the loan.
- Milestone payments received for projects identified in the advisory letter and term sheet would be included in the calculation of Product Revenue, but would not trigger the obligation to make risk premium payments unless the project results in commercial revenues.
- Genentech's commonly used definition for Net Commercial Sales was integrated into the definition of Product Revenue.
- The interim regulation has a sunset clause. This program will only be available for one year after the effective date of the interim regulations. Thereafter, unless the regulation is extended, Loan Recipients will be required to comply with the warrant requirements of the Loan Administration Policy.

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MEMORANDUM

To: Members, Governing Board
California Institute for Regenerative Medicine

From: James C. Harrison

Date: December 3, 2010

Re: Loan Program (Our File No.: 2297-0)

INTRODUCTION

At its meeting on December 3, 2010, the Finance Subcommittee voted to recommend two approaches designed to make the loan program more attractive to industry. These approaches are not mutually exclusive. The Board could adopt one of the proposals or both proposals. If the Board were to adopt both proposals, loan recipients would be required to choose, at the commencement of the loan, which form of risk premium they desire. This memorandum briefly describes the two approaches.

A. Amendment of the Loan Administration Policy Warrant Provisions

1. Current Regulations

Currently, the Loan Administration Policy requires that loan recipients provide CIRM with warrants as a risk premium. For company-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) 10% of the loan amount if loan recipient shows a profit for previous two years;

(2) 25% of the loan amount if the loan recipient has: (a) raised in prior financings since its inception three times the total amount of the loan; AND (b) entered into a contractual arrangement (still in

effect) with a biotechnology or pharmaceutical company which requires the payment of licensing revenues or milestone payments predicated on the success of a funded project (regardless of whether it is a CIRM Funded Project); or

(3) 50% of the loan amount if the loan recipient has met only one of the two requirements set forth above in (2);

(4) 75% of the loan amount if none of the criteria set forth in (2) are satisfied.

For product-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) 50% of the loan amount if the loan amount is less than 50% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award;

(2) 60% of the loan Amount if the loan amount is between 50% and 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award; or

(3) 100% of the loan amount if the loan amount represents more than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award.

Some industry representatives have expressed concern regarding CIRM's warrant coverage requirements. In an effort to address those concerns, the Chair of the Loan Task Force, Duane Roth, proposed modifying the warrant coverage as set forth below.

2. Proposed Company-Backed Loan Amendment

Warrant coverage for company-backed loans would be modified as follows (deletions are reflected in strike-out text and additions are in bold and italics):

For company-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) 10% of the loan amount if loan recipient shows a profit for previous two years;

(2) 25% of the loan amount if the loan recipient has: (a) raised in prior financings since its inception three times the total amount of the loan; ~~OR AND~~ (b) entered into a contractual arrangement (still in effect) with a biotechnology or pharmaceutical company which requires the payment of licensing revenues or milestone payments predicated on the success of a funded project (regardless of whether it is a CIRM Funded Project); or

(3) 50% of the loan amount if the loan recipient has *not* met ~~only one of the two~~ *either of the* requirements set forth above in (2); 75% of the loan amount if none of the criteria set forth in (2) are satisfied.

3. Proposed Product-Backed Loan Amendment

Warrant coverage for product-backed loans would be modified as follows (deletions are reflected in strike-out text and additions are in bold and italics):

For product-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) *the amount of CIRM's contribution as a percentage of 50% of the loan amount if the loan amount is less than 50% of the total funds required to complete the CIRM-Funded Project, as defined in the Notice of Loan Award; **this allocation will be determined at the time of each loan disbursement, e.g., if CIRM's funds represent 60% of the project costs for the period covered by the first disbursement, the loan recipient would be required to provide CIRM with warrant coverage equal to 60% of the project costs during the period covered by the first disbursement; if CIRM funds represent 30% of the total project costs during the period covered by the second disbursement, then CIRM would be entitled to warrant coverage equal to 30% of the total project costs for that period.***

~~(2) 60% of the loan amount if the loan amount is less than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award; or~~

~~(3) 100% of the loan amount if the loan amount represents more than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award.~~

Because these provisions are included in the Loan Administration Policy, which is currently undergoing review by the Office of Administrative Law, CIRM would have to open a new rule-making to adopt these changes. This process would require approximately four to five months before the revised warrant provisions would become effective. The Loan Administration Policy permits an amendment to be applied retroactively, provided the loan recipient and CIRM agree.

The Finance Subcommittee recommended this proposal for the Board's consideration by a vote of 10 to 0.

B. Payback Alternative

Bob Klein, the Chair of the Governing Board, proposed, on a one-year trial basis, an alternative to warrant coverage. Under Mr. Klein's proposal, a loan recipient could opt for warrant coverage or, in the alternative, could agree to repay CIRM, in addition to principal and interest, a multiple of the loan amount, depending upon the level of success achieved, as a risk premium. This proposal is set forth in attachment A. If adopted, it would sunset after one year.

Under Proposition 71, the Board has authority to adopt "interim" regulations outside the scope of the Administrative Procedure Act. Because the payback alternative is not currently addressed by an existing regulation, the Board could adopt the payback alternative as an interim regulation. Interim regulations take effect immediately upon adoption by the Board and survive for 270 days, affording time to adopt a final regulation pursuant to the Administrative Procedure Act. In addition, as discussed above, the Loan Administration Policy permits an amendment to be applied retroactively, provided the loan recipient and CIRM agree.

The Finance Subcommittee recommended this proposal for the Board's consideration by a vote of 7 to 3.

RISK PREMIUM PAYBACK MULTIPLE OPTION*

*Proposed for one year trial period with re-evaluation at the end of the one year period

