

Government R&D Incentives

Next Tenders on the Way - Franchises for Israeli Government Sponsored Technological Incubators

Competitive tenders for franchises to form and operate government-supported technological incubators are expected to take place towards the end of 2014.

A government franchise to form and operate a technological incubator is based on a unique model which offers business opportunities for Israeli and foreign corporations and investment funds. Multinational corporations, such as **Hutchison, Philips, Nielsen, Takeda, Johnson&Johnson, Elbit, Teva Pharmaceutical, operate government-supported incubators following their selection through prior tenders.**

By forming an incubator, **the franchisee gains access to Israeli deal flow and innovation (entrepreneurs, startups, academia) in its technological field of interest, and is able to invest in and work with the entrepreneurs and ideas it finds the most promising.**

The franchisee also receives substantial equity (20%-50%) in the startups that operate in the incubator in exchange for a relatively small investment (15% of the startups' R&D budget for 2 years), while the government funds the bulk of the costs (85% of the R&D budget for 2 years).

If you are considering setting up a government-supported incubator, you should get prepared in advance of the next round of bids. Participating in a tender for an incubator and writing the bid proposal require a substantial amount of time and effort (e.g. recruiting the incubator's management team, writing investment and business plans, locating offices). The process is more complicated and time-consuming for bidders that are multinationals or large corporations. In addition, in light of the long term obligations involved in the franchise and the shareholding in the incubator and the incubator companies, it is essential to consider in advance structuring and legal implications, including tax, IP ownership, financing, labor and commercial issues. Structural changes may not be permitted after winning a tender. **Also, it is possible that in the coming tenders applications will only be allowed with at least one partner.**

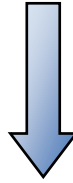
Herzog Fox & Neeman has extensive experience in advising on these issues, and would be happy to assist you as required. **Should you require any further information or clarification regarding the issues discussed in this circular, please do not hesitate to contact us.**

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Competitive tenders to form and operate government-supported technological incubators



Johnson + Johnson



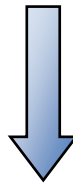
Winners receive 8 years franchise to form and operate an incubator in a certain geographical region.

Obligated to inject the incubator at least NIS 1.26 per year to cover the incubator's operation costs (in addition to the 15% R&D funding)

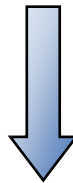


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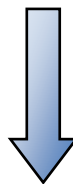


The incubator locates and screens entrepreneurs and startups to operate within the incubator



Startups that are accepted to the incubator receive:

- R&D funding from the government (85%) and the incubator (15%) for at least 2 years.
- Other support from the incubator (R&D infrastructure, business advice, administrative services).



The incubator receives 20%-50% equity in each startup

Government-Supported Technological Incubators in a Nutshell

Goal – To help entrepreneurs establish start-up companies to take their innovative ideas and develop them into commercial technologies, and to make such companies attractive for private-sector investments.

Framework – A government R&D funding incubator program administrated and implemented by the Incubator Administration of the Office of the Chief Scientist of the Israeli Ministry of Economy (the "OCS") by virtue of the Law for Encouragement of Research and Development in Industry 5744-1984 and accompanying regulations (the "R&D Law") and Circular No. 8.3 of the General Director of the Israeli Ministry of Economy (the "Circular").

Concept

- The incubator locates and screens companies that will be invited to operate within the incubator ("Incubator Companies"). Each selected company must be approved by the Incubator Administration along with the government financial support to be provided based on the R&D budget.
- The government provides funding for 85% of the approved R&D budget of the Incubator Companies for a two year period. Government funding may be available for a third year in certain cases.
- During this period, the incubator provides a wide range of support to the Incubator Companies, including R&D infrastructure (space, labs, equipment), technological and business advice, introduction to strategic partners and investors, assistance in recruiting and fundraising and administrative services (accountants, lawyers, regulatory advice, secretarial support, etc.).

The Franchise

- The franchise for forming and operating a government-supported incubator is for 8 years.
- A franchisee must set up an Israeli legal entity (company or partnership) to be the incubator. The shareholders of the incubator may be non-Israelis.
- The incubator must be located in the geographical region that is determined in the tender.
- The franchisee is selected by the "Incubator Committee" through a competitive bidding process. The criteria include: franchisee's team and shareholders, their experience with technological companies (start-ups in particular), their potential contribution to the Incubator Companies, the franchisee's business plan, its funding resources and general impressions.

Franchisee's Obligations

- Operating and funding the incubator with an annual budget of at least NIS 1.26 million invested by the franchisee. Incubators that are located in Israel's periphery may receive government participation of up to 49% of operational costs.
- Investing 15% of the approved R&D budget of each Incubator Company in the two year period that the Company participates in the incubator.

Government Funding

- The government support in an Incubator Company is provided for two years. Incubator Companies engaged in clean-tech, medical devices and biotechnology (and at times in other fields) may receive reduced government funding for a third year in the incubator.
- The approved R&D budget of the Incubator Companies in the two year period and the 85/15 R&D funding allocation (in NIS millions) based on the Circular dated November 10, 2013:

Company's Field	Approved Budget		Government Funding (85%)		Incubator Funding (15%)	
	Ordinary	Periphery	Ordinary	Periphery	Ordinary	Periphery
General	2	2.5	1.7	2.125	0.3	0.375
Cyber	2.2	2.7	1.87	2.295	0.33	0.405
Medical Devices	2.5	3	2.125	2.55	0.375	0.45
Biotechnology	3	3.5	2.55	2.975	0.45	0.525

Repayment of Government Support – The Incubator Companies (**not** the incubator) are liable to repay the government funding received plus interest at the rate of LIBOR through royalties on future revenues (generally at the rate of 3-3.5%). The total amount of royalties as well as the royalty rate may increase if products that are connected (directly or indirectly) to the government funding are manufactured outside of Israel.

Rights in Incubator Companies – Determined based on the agreement between the entrepreneurs and the incubator subject to the following guidelines: *entrepreneurs* – 50%-70%; *the incubator* – 20%-50%. The Israeli government **does not** receive shares in the Incubator Companies.

Security – The franchisee has to provide security to the government of NIS 1.26 million for the franchise period to guarantee its obligations under the franchise.

The R&D Law – Applies to the government funding the Incubator Company receives. Therefore, the basic rule is that any know-how resulting, directly or indirectly, from the government funding, and any right in such know-how, must be owned by the Incubator Company and may not be transferred outside of Israel or to a foreign entity (including for the purpose of manufacturing or further R&D), unless otherwise is approved in accordance with the provisions of the R&D Law. The limitations under the R&D Law also apply after the Incubator Company ceases to operate within the incubator or after the government funding was fully repaid by the Incubator Company.

The franchise does not provide any relief to foreign shareholders in the incubator in respect of the limitations under the R&D Law, including those concerning the ownership of know-how and the exploitation of know-how.

This publication is intended as a general guide only. It should not be regarded as legal advice and should not be relied upon. The readers should seek specific professional advice in applying the applicable law to any specific situation.

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