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MEMORANDUM

VIA EMAIL

To: Dr. C. Randal Mills, President and Chief Executive Officer
California Institute for Regenerative Medicine

From: Margaret R. Prinzing

Date: July 22, 2014

Re: Review of Recent CIRM Transactions Involving Stem Cells, Inc.
(Our File No.: 2297-0)

INTRODUCTION

You have asked us to review three recent transactions involving Stem Cells, Inc. (“SCI”), a CIRM loan recipient, to determine whether Dr. Alan Trounson, CIRM’s former president, participated in, or attempted to influence a CIRM decision involving SCI after he began discussions with SCI about joining the company’s Board of Directors.¹ There were three potential transactions negotiated between SCI and CIRM during the relevant time period. These involve a proposed amendment to the SCI loan agreement initiated by CIRM, a request from SCI that CIRM agree to subordinate its loan to a commercial loan to SCI, and a request from SCI that CIRM make a semi-annual disbursement to SCI notwithstanding the fact that SCI did not, at the time, meet a financial milestone included in its loan agreement with CIRM. As described in greater detail below, we have found no evidence that Dr. Trounson made, participated in, or attempted to influence, a CIRM decision involving SCI after he began negotiations with the company to join its Board of Directors.

¹ Because James Harrison was one of the CIRM team members involved in recent transactions relating to Stem Cells, Inc., I took a leading role in conducting the review and personally interviewed the relevant CIRM team members.

BACKGROUND

In September 2012, CIRM's Board approved a \$19.3 million loan to SCI to support pre-clinical research regarding the use of neural stem cell transplantation to treat Alzheimer's disease. After negotiating scientific milestones and the financial terms of the loan, CIRM and SCI executed a Notice of Loan Award and Loan Agreement on April 10, 2013, and CIRM made its first semi-annual disbursement to SCI on July 8, 2013. To date, CIRM has disbursed approximately \$7.6 million to SCI.

In November 2013, CIRM decided to transfer responsibility for conducting on-going financial due diligence of its three loan recipients, including SCI, from an outside contractor to a CIRM employee. This change would have a beneficial effect on the loan recipients, including SCI, because it would increase the amount of CIRM's disbursements. (CIRM formerly withheld a portion of disbursement, equal to \$10,000 for each year of the loan term, to cover the costs of paying the outside contractor.) In May and June of 2014, CIRM team members Gabriel Thompson and James Harrison prepared amendments to CIRM's loan agreements to conform to the new policy. Gabriel Thompson mailed the proposed loan amendment to SCI on July 2, 2014. To date, SCI has not returned an executed copy of the loan amendment to CIRM and CIRM is not aware of any attempt by SCI to accelerate or influence the amendment process.

Dr. Trounson contacted Martin McGlynn, SCI's President and Chief Executive Officer, on May 1, 2014 to set up a meeting to discuss his future plans. Based on a calendar entry, it appears that Dr. Trounson and Mr. McGlynn met on June 4, 2014. On June 9, 2014, SCI offered Dr. Trounson a seat on SCI's Board of Directors, subject to the Board's approval. SCI made the appointment on July 7, 2014. Had SCI notified CIRM at the time of its offer to Dr. Trounson, CIRM would have taken steps to wall Dr. Trounson off from any involvement in decisions relating to SCI.

On June 20, 2014, Ken Stratton, SCI's General Counsel, contacted Elona Baum, CIRM's then-General Counsel, by email to request a telephone call to provide an update on SCI. Ms. Baum responded that Mr. Stratton should contact James Harrison to discuss the matter. Mr. Stratton called Mr. Harrison on June 23, 2014 to ask whether CIRM would agree to subordinate its loan to a commercial loan. Under CIRM's loan agreement with SCI and the Loan Administration Policy, SCI has the authority to incur additional indebtedness arising from credit facilities, term loans and other debt financings, and CIRM has the authority to agree to subordinate its loan to new debt. CIRM and SCI are continuing to discuss the matter and, to date, the parties have not executed a subordination agreement.

On June 27, 2014, Martin McGlynn, SCI's CEO, emailed Dr. Ellen Feigal, CIRM's Senior Vice President for Research and Development, to provide financial information and to request that CIRM make its scheduled July 1, 2014 disbursement, notwithstanding the fact that, at that time, SCI could not satisfy a financial milestone in the parties' loan agreement.

Dr. Feigal forwarded Mr. McGlynn's request to CIRM team members Gabriel Thompson, Ian Sweedler, and Neil Littman for evaluation. After consulting with James Harrison, the team recommended to Dr. Mills that he approve a partial disbursement to SCI in order to allow SCI to continue the Alzheimer's program while it completed a pending financing that would enable it to satisfy CIRM's financial milestone. Dr. Feigal notified Mr. McGlynn on July 3, 2014, that CIRM would make a partial disbursement in July and release the remaining funds upon submission of documentation to CIRM that SCI had satisfied CIRM's financial milestone. On July 7, 2014, CIRM placed a check for the partial disbursement into an envelope for delivery to SCI on July 8, 2014.

On July 7, 2014, SCI issued a press release announcing that the company had appointed Dr. Trounson to its Board of Directors. SCI did not notify CIRM of Dr. Trounson's appointment before issuing its press release. In order to ensure that Dr. Trounson had not participated in, or attempted to influence, the disbursement request or any other CIRM action relating to SCI after he began discussions with SCI to join its Board, CIRM instructed its overnight carrier to cancel the delivery of the check and requested that the State Controller cancel payment on the check. CIRM notified SCI that it would withhold the disbursement until it completed its review.²

SUMMARY OF POST-EMPLOYMENT RESTRICTIONS

California law prohibits a state employee from making, participating in making, or using his official position to influence, any governmental decision directly relating to any entity with whom the employee is negotiating, or has any arrangement, concerning prospective employment. (Gov. Code, § 87407.)

California law does not restrict former state employees from accepting employment after leaving state service, even if the employment is with an entity with which the former employee's agency has a contract. Therefore, it is permissible under state law for a former employee, like Dr. Trounson, to accept a position with a company that has received funding from CIRM. However, state law prohibits former CIRM employees from:

1. Communicating with CIRM Board members, employees, and consultants (including members of the Grants Working Group) on behalf of their employer for the purposes of influencing any administrative action, including the award or revocation of a grant or loan, involving their employer for one year following the termination of their employment with CIRM; and

² On July 18, 2014, SCI notified CIRM that it had completed a financing and could now satisfy CIRM's financial milestone.

2. Participating in any proceeding before CIRM involving their employer if the employee was involved in the proceeding while employed by CIRM. For example, if a CIRM employee participated in drafting a Request for Applications, the employee may not assist his or her employer in preparing an application in response to the request.

(Gov. Code, §§ 87400 et seq.)

As it does with all departing employees, CIRM advised Dr. Trounson of these restrictions before he left the agency. Upon learning of Dr. Trounson's appointment to the SCI Board, CIRM reminded Dr. Trounson of his obligations and notified SCI's general counsel of the state law restrictions on Dr. Trounson's activities. In addition, CIRM has instructed its Board members and employees to refrain from engaging in communications with Dr. Trounson regarding SCI.

PURPOSE AND SCOPE OF REVIEW

The purpose of our review was to determine whether Dr. Trounson made, participated in making, or attempted to influence, any decision before CIRM involving Stem Cells, Inc., from the time he began negotiating with Stem Cells, Inc. regarding a potential Board appointment, to the present. Because we do not know the exact date on which Dr. Trounson began negotiating an appointment to the company's Board of Directors, we used May 1, 2014, the first date on which the parties had any known contact regarding the matter, as the starting point for our review.

The scope of our review extended to the three transactions involving SCI that occurred between May 1, 2014 and the present:

1. Request for July 1, 2014 loan disbursement.
2. Request for CIRM to subordinate its loan to a commercial loan.
3. Amendment to SCI's loan agreement to reflect the fact that CIRM is conducting financial due diligence in house rather than through an outside consultant.³

³ Although CIRM initiated the proposed amendment, we included it within the scope of our review because CIRM made decisions regarding the proposed SCI amendment during the relevant period of time. As a result, Dr. Trounson could have influenced these decisions after he began discussions with SCI about joining its board.

As part of our review, we interviewed the following CIRM team members:

C. Randal Mills, President and Chief Executive Officer
Ellen Feigal, Senior Vice President, Research and Development
James Harrison, Counsel
Gabe Thompson, Grants Management Officer
Neil Littman, Business Development Officer
Ian Sweedler, Counsel
Manda Mora, Executive Assistant to CEO
Alex Campe, Human Resources Officer

In addition, we asked each of these team members whether other CIRM employees were involved in these decisions. As a result, we also contacted Pat Olson, Executive Director, Scientific Activities, and Chila Silva-Martin, Finance Director.

We also reviewed documents relating to these transactions, including CIRM email and calendar entries during the relevant period relating to Stem Cells, Inc.

We contacted members of CIRM's Board by email to ask whether they had had any contact with Dr. Trounson during the relevant period.

Finally, we contacted Dr. Trounson by email to ask him whether he had contact with any CIRM Board members or employees during the relevant period regarding Stem Cells, Inc.⁴

REVIEW FINDINGS

When interviewing Randal Mills, Ellen Feigal, James Harrison, Gabe Thompson, Neil Littman, Ian Sweedler, Manda Mora, and Alex Campe, I asked each whether they knew about any effort by Alan Trounson to participate in, or influence, a decision before CIRM regarding Stem Cells, Inc., from May 1, 2014 until the present. Each person answered no. Each individual continued to say no when I asked more specifically, whether they knew about any effort by Dr. Trounson to participate in, or influence, CIRM's decision concerning (1) Stem Cells, Inc.'s request to receive its July 1, 2014 loan disbursement notwithstanding the fact that it had not met a financial milestone in the parties' loan agreement at the time of the disbursement

⁴ Our review is necessarily limited by the fact that CIRM does not have the authority to issue subpoenas or discovery requests, in the absence of litigation.

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request; (2) Stem Cells, Inc.'s request for CIRM to subordinate CIRM's loan to Stem Cells, Inc. to a loan from a commercial lender; and (3) a proposed amendment to Stem Cells, Inc.'s loan agreement to conform to the fact that CIRM has transferred responsibility for conducting financial due diligence in-house.

When we followed up with Pat Olson and Chila Silva-Martin to ask them the same questions, they also said that no, they were unaware of any effort by Dr. Trounson to participate in, or influence, any of these decisions.

Dr. Mills explained that he was not familiar with the SCI program at the time CIRM team members contacted him about the company's disbursement request. As a result, he relied upon CIRM team members in approving the request. As discussed above, however, we have confirmed that Dr. Trounson did not attempt to influence any of the CIRM team members upon whom Dr. Mills relied.

We reached out to Board members by email to ask whether Dr. Trounson contacted them regarding SCI during this period and found no such contacts.

We also contacted Dr. Trounson, who has returned to Australia, by email to ask him whether he had participated in, or attempted to influence, any decision regarding SCI after he began negotiating with the company regarding a board appointment. He responded that he had had no such contacts.

Finally, although we found evidence that Dr. Trounson began discussions with SCI about joining its Board before he left CIRM employment, we found no documentary evidence that he had participated in, or otherwise attempted to influence, any CIRM decision relating to SCI during the relevant period.

CONCLUSION

Based on the information that is currently available to us through personal interviews, email contacts, and a review of CIRM documents and emails, we have found no evidence that Dr. Trounson made, participated in making, or attempted to influence, a CIRM decision involving SCI from May 1, 2014 to present.

MRP:NL
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