THOMPSON HINE

Business Law Update

Summer 2012

Mergers & Acquisitions

CH Energy Group, Inc.

On February 20, 2012, longstanding Thompson Hine client CH Energy Group, Inc. (NYSE: CHG) entered into a merger agreement with Fortis Inc. and its wholly owned U.S. subsidiaries FortisUS Inc. and Cascade Acquisition Sub Inc. Fortis Inc. is listed on the Toronto Stock Exchange (TSE: FTS). CH Energy Group is a New York-based energy delivery systems company. Fortis, the largest investor-owned distribution company in Canada, serves more than 2 million gas and electricity customers and reported fiscal year 2011 revenue of approximately $3.7 billion. The aggregate merger consideration is approximately $1.5 billion. A Thompson Hine team that included lawyers in our corporate and securities, real estate, employee benefits and executive compensation, and tax practice groups, worked together with special merger and acquisition counsel, Wachtell, Lipton, Rosen & Katz, to advise CH Energy Group on the transaction.

The notable terms of the merger agreement include the payment to CH Energy Group shareholders of all-cash consideration equal to $65 per share of common stock. In addition to providing liquidity and certainty to the shareholders, the $65 per share consideration represents an approximate 9.5 percent premium over the all-time, pre-announcement trading high for shares of CH Energy Group, a multiple of 10.4 times its 2011 EBITDA and 21.9 times its 2011 earnings per share. The company believes that the price premium and those multiples are among the highest such measures for comparable utility company acquisitions in the past 10 years.

CH Energy Group will be a wholly owned indirect subsidiary of Fortis Inc. The company will maintain its current Poughkeepsie, New York headquarters and operate with a substantial degree of independence under Fortis' federation-style model for the utilities it owns.

The merger is conditioned on securing various governmental approvals and the approval of the shareholders of both companies. The parties presently anticipate that the merger will be completed during the first quarter of 2013. CH Energy Group will be able to continue to pay dividends to its shareholders until the merger is completed.

Thompson Hine continues to represent CH Energy Group across multiple practice areas, including litigation, corporate, real estate, employee benefits and executive compensation, bankruptcy and environmental. The Thompson Hine team is led by Joseph B. Koczko and George J. Walsh, III, with dedicated assistance from lawyers across a number of our firm's practice areas.

Corporate Merger Results in Termination of Employee Noncompetition Covenants

By Frank D. Chaiken

A recent decision by the Ohio Supreme Court presents another challenge to the widely understood rule of corporate law that in a merger of corporations or other business entities, the existing rights and obligations of the constituent or target companies continue in force, especially their valuable contract rights and obligations. This fundamental principle has come under attack from competing public policy considerations, particularly involving employment and intellectual property contracts. Companies engaging in mergers and acquisitions accordingly need to take particular care that contracts in these and other business-critical areas are properly conveyed and continue to be enforceable upon completion of a transaction.

In *Acordia of Ohio LLC v. Fishel*, the surviving company in a merger sued employees of the acquired company to enforce noncompetition agreements they had entered into some years earlier when the employees left to join a competitor. The Ohio Supreme Court, by a 4-3 margin, blocked that effort on May 24, 2012, holding that the merger of two companies effectively terminated the existence of the acquired company, thereby terminating the agreements and causing the two-year noncompetition period to begin running. The noncompetition agreements referred specifically to the acquired company by name, but did not include a clause making them applicable to the company's legal successors and assigns. Because more than two years had passed following the merger before the employees left the company, the passage of time had released the employees from their noncompetition obligations, and accordingly, the surviving company's lawsuit failed.

The court's ruling might surprise some corporate lawyers … the Acordia decision hearkens back to a 2009 decision by the United States Court of the Appeals for the Sixth Circuit … Cincom v. Novelis …

The surviving entity in the merger argued, in accordance with the state merger statute, that the rights and obligations of the constituent company continued uninterrupted as a matter of law, and the employee contracts remained in force after the merger. The two-year covenant therefore should have commenced on the date the employees left the surviving entity, not the date of the merger.

The court's ruling might surprise some corporate lawyers, who would point to the Ohio merger statute, Section 1701.82 of the Ohio General Corporation Law, which provides that a surviving entity in a merger continues to possess, by operation of the merger, "without further act or deed," all assets, property, interests and obligations of the constituent entities to the merger. In fact, most corporate lawyers would understand that the constituent entities' existence continues uninterrupted following the merger, embodied in the surviving entity. This view was pointed out in one of the dissenting opinions in the *Acordia* case, and numerous other courts have reached this conclusion.

Nonetheless, the *Acordia* decision hearkens back to a 2009 decision by United States Court of the Appeals for the Sixth Circuit. In *Cincom v. Novelis*, the Sixth Circuit ruled that a merger of two entities invalidated certain license rights to intellectual property held by one of the constituent entities. The court's

theory appears to be similar to that in the *Acordia* case, namely that the entity holding the license rights ceased to exist as a result of the merger, so the rights had to be "assigned" to the surviving entity by operation of law. The license agreement prohibited such an assignment without consent of the licensor, which consent had not been given. The result in *Cincom* was even more surprising because the constituent entities to the merger were owned by the same parent company so there was no actual change of beneficial ownership of the companies.

A common theme in these cases seems to be that rights of a special or personal nature were involved. These types of contract rights generally are not transferable absent an express agreement of the parties. Courts construe noncompetition covenants narrowly for public policy reasons. Accordingly, the majority of the Ohio Supreme Court in *Acordia* was unwilling to extend the covenants where the employees had not agreed specifically that they would survive following the employer's merger with another company. Similarly, a license of intellectual property was viewed by the Sixth Circuit as fundamentally linked to the nature and identity of the company receiving the license, so that any change in the corporate structure of the licensee resulted in termination of the license, absent an express agreement to the contrary.

Not all state and federal courts would agree with the *Acordia* and *Cincom* decisions. However, in both cases, specific language in the agreements allowing assignment and providing that the rights granted would survive an assignment, merger, consolidation, sale of shares or other change in control of the company could have preserved the rights for the successor company. Until there is a firmer consensus around the country, parties would be prudent to include such language in their agreements to protect these valuable contract rights in the event of subsequent corporate structural or ownership changes. Companies should consider renewing any existing employee noncompetition agreements to include appropriate succession language. Acquiring companies should be particularly attentive during due diligence so they are not unpleasantly surprised about the scope of contractual rights they are acquiring.

For more information on merger activity, contact Frank D. Chaiken.

Investment Management

Monetizing Intellectual Property – Make Your IP a Fountain Instead of a Drain

By Beverly A. Lyman, Ph.D., Esq.

Intellectual property (IP), long a valuable legal asset, has even greater potential in a corporate portfolio. This article will help you recognize and use IP as a financial asset as well as a legal asset. Markets demand it and speak with a clear, definitive and unified voice: IP assets are not optional. Any transaction without IP, if it is effected at all, is relegated to junior status.

What's driving this recognition of IP? How can you create valuable IP assets for your business? How can you showcase your company's existing IP and get those assets ready for their "coming out party"? Keep reading.

It's worth taking a moment to define IP. IP includes patents, trademarks, copyrights and trade secrets. It also includes the immature stages of each: patent and trademark applications filed with the U.S. Patent and Trademark Office and applications filed with the Library of Congress for copyright registrations. With regard to patents, IP reaches back even further to include invention disclosures that are not yet applied for or formalized, i.e., the germ of an

invention. Trade secrets are defined as any information that is both maintained in secret and has commercial value (actual or potential); the scope is vast.

So you have IP; how do you value it? That's the easy part, because value is whatever you as the owner perceive it to be. It's important to ensure that your perceptions are accurate and market-backed. A more interesting question is: How do you monetize IP? Monetization provides a pathway (capital) to reach an end result that puts your IP to work for you. The distinction is even more prescient due to current trends toward *strategic use* of IP in acquisitions (How can I best leverage the IP I acquire?), versus mere financial accounting of IP in acquisitions (How can I get the best deal on the IP I acquire?).

What are some creative uses of your IP? You likely already know and may even practice many of these. A tried and true way to use IP has been to "EEL" it – exploit it, enforce it, license it. You put your existing IP up against the IP and/or products of competitors in your industry and, as in a Venn diagram, seek to carve out more scope for your business by offensively asserting your IP where and when you can. While this method remains viable and valuable, a newer corollary seeks an ongoing financial value add-on. Using a less confrontational and more collegial mindset, we now seek opportunities to provide a revenue source or stream from IP, instead of a one-time win. Here are some examples:

- IP as a securitization asset. Yes, your "intellectual" property is as useful in securitization as your "real" property. Like real property, the more robust, mature, developed and desirable it is, the more it is worth as security. So you follow the same maxim as you do in dealing in real property: maintenance. Ensure your "neighborhood" remains desirable. Discard outdated items and modernize to keep current. Using IP as a security asset allows your business to advance even if other capital (read: cash) can be difficult to attain at the time you need it.

- IP as a trade or barter vehicle. Licensing IP that supports a platform is not new, but what about cross-licensing IP? Cross-licensing can achieve a specific desired end result, such as avoiding infringement litigation, but it can also accomplish more. For example, it can be a vehicle for each side to gain entry to a complementary new technology without having to do all the legwork and without having to advance capital. If you include trademarks and their associated goodwill with the cross-license, each side gets a ready-made mature market from which it can expand. A win-win result!

- IP as a litigation vehicle. So-called trolls ("non-practicing entities" or NPEs) have already exploited this use of both copyrights and patents to extract fees. It may not be pretty, but it can be effective in generating revenue by working existing IP that would otherwise go untapped. This is particularly true if you have or can obtain expertise in evaluating and charting patent claims and prosecution histories to find and exploit informational nuggets. IP can also be used to finance litigations. Say you have a good faith belief that a competitor is infringing your IP, but lack the economic or other resources to finance expensive litigation. You can assert the strength of your IP with a more robust partner doing the heavy lifting. The IP asset's worth would be assessed by standard cost, market and/or income methods, compared against the cost of the litigation and the likelihood of a desired outcome.

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However you choose to "work" your IP, you need to be smart about it. This requires vigilance. While the ideal IP portfolio is dynamic, particular pieces of it are static (the exception being trademarks which, by law, must be dynamic to remain viable). But neither technology nor markets are static, so you must constantly tweak your portfolio to maximize your return on investment. Another unknown factor is consumer or customer preferences – they shift. This requires that your IP portfolio align with your business at the point where you want your business to go, instead of where it's been (so yesterday!).

Today's IP decisions are made in the C-suite by business executives; yesterday's were made in research conference rooms by engineers and scientists. Look at your IP portfolio. Is it a revenue drain, costly to obtain and maintain? Or is it a revenue source that can be optimized and worked to maximize value? Knowledge, empowerment and a change in perspective can make the difference in your outcome.

For more information on intellectual property, contact Beverly Lyman, Ph.D.

Private Companies

So You Want to Sell Your Company?
Key Considerations for the Sale of a Private Company

By Tony Kuhel and William M. Henry

The sale of any private company is a complex process that has the capacity to change lives. While the buyer and seller share a common goal (to close the sale), at the heart of the sale process is a conflict in interests and priorities. On the one hand are the current owner, management team and employees of the seller – the known – who have invested months, years or even their entire careers growing the company. On the other hand is the buyer – the unknown – who often comes with comparatively little knowledge of the company and its past performance but promises future success and (hopefully) a significant amount of money. Even with thorough planning and extensive due diligence review of the target, there are often unforeseeable difficulties to be addressed by both buyer and seller, and the differing perspectives of the parties often complicate resolution of these issues. Having financial and legal advisers to guide the parties through this process is often just as important as advising a seller during negotiation of the transaction documents to be executed at closing. As we enter what is shaping up to be a busy second half of 2012 in terms of private company M&A activity, we offer a few key considerations that should be top-of-mind for every seller.

Timing

The recent volatility of the economy, the rapid rate of change in most industries and the turmoil of an election year render the timing of the transaction (along with valuation) to be one of a seller's most important considerations. Actually, timing and valuation are often related: the more patient you are, the more time you have to wait for the perfect offer. However, if you need to sell immediately, flexibility on price and other negotiated issues may be required. Despite what buyers – and even some advisers – may promise at the outset, a well-run, middle market M&A sale process frequently takes between three and six months. So the first step for any seller is to establish a conservative closing date or range of dates and plan the rest of the sale process accordingly.

Due Diligence

Few things frustrate a buyer more and slow down a sale process faster than dealing with a seller who has incomplete or poorly organized records. While every seller should expect to be bombarded with due diligence requests, a well-organized, comprehensive and efficient due diligence program will reduce transaction risk and costs for all parties. A buyer noticing an apparent lack of organization will ask questions like, "*Are you sure you don't have any environmental reports, or did you just lose them?*" or *"Are your financial projections based upon reliable and accurate historical results and sound and supportable growth targets?"* Questions like these can erode the most valuable commodity in any transaction – trust – and even plausible answers to these questions may be met with skepticism. Also, any increase in transaction risk will impact

other aspects of the transaction; a skeptical buyer may require stricter representations and warranties, more security for post-closing obligations (including possible personal guaranties in closely held corporations), broader indemnities or, worse yet, a purchase price reduction. Given the importance of due diligence to the buyer and the effect a poor diligence process has on the sale process, having organized records should be a top priority in every sale transaction.

Marketing

A seller usually goes to market in one of two ways: either the seller knows of potential buyers and contacts them directly, or the seller goes through an auction process (typically conducted by a financial adviser). Which road the seller takes often depends on its financial goals (Is the goal to maximize value by contacting as many buyers as possible? Or to only approach a select group of potential purchasers?), the nature of the industry and the seller's desired timeline. If the seller wants an auction, it will take time for the seller and the financial advisers to prepare and conduct a well-run auction. This added complexity must be accounted for in the overall transaction timeline.

Even with thorough planning and extensive due diligence review of the target, there are often unforeseeable difficulties to be addressed by both buyer and seller, and the differing perspectives of the parties often complicate resolution of these issues.

Transaction Structure

One of the first instances where a divergence in the interests of buyer and seller becomes apparent is on transaction structure. Buyers generally prefer to purchase assets, since the buyer can select the assets and liabilities it wants to purchase, and sellers prefer to sell equity, since the buyer assumes all the seller's assets and liabilities. However, depending on the type of company being sold (for example, an LLC, corporation or partnership), there may also be tax distinctions between a stock or asset structure that can save or cost the sellers a significant amount of money and impact the price (for better or worse) that a buyer may be willing to pay for the business. Further, factors related to the seller's operations, including number of employees, number and relative importance of contracts, regulatory approval or compliance concerns, can also affect potential transaction structures. The seller, with assistance from experienced accountants and lawyers, should decide upon a preferred transaction structure before approaching buyers, who ordinarily will have their own preferences. Depending upon the tax basis for the seller's assets and its overall tax circumstances, the advantages of selecting a tax or asset sale may be so significant that the parties will seek to quantify the tax savings and negotiate an allocation of the savings between themselves.

Employees

That a company is up for sale starts as a closely guarded secret known only to owners and senior management, but word often spreads beyond those who "need to know." Once it does, employees naturally become concerned over whether the potential sale of the company will lead to downsizing. This concern can lower morale and may cause some employees, often the most valuable ones, to begin updating their résumés at a time when the seller needs them the most. A seller should have a well-defined plan for informing employees of the pending transaction at an appropriate stage of the sale process. Those identified as key employees should be actively engaged to help ensure that they remain with the business through closing (but in a manner that does not tie the hands of the buyer). Strategies to consider include retention bonuses and covenants from the buyer that clearly outline obligations to employees post-closing.

In our experience, a realistic timeline, due diligence preparation, an appropriate go-to-market strategy, an efficient transaction structure and attention to employee concerns are each critical to maximizing value in a sale process. Attention to these key elements can help ensure that the closing of a complex, sometimes daunting transaction is one of the best (and hopefully most profitable) days of your life.

For more information on the sale of private companies, contact Tony Kuhel or William M. Henry.

Using Consignments as Alternative Financing Arrangements While Protecting Suppliers From Their Pitfalls

By John D. Cottingham and Garrett A. Nail

The prolonged downturn in the economy and the corresponding stresses to business cash flow have made some traditional commercial transactions between customers and suppliers more challenging. On one hand, suppliers face increased risk when selling to customers with poor or deteriorating credit, and on the other hand, difficulty in accessing credit may mean that customers have limited working capital available to invest in inventory. Carefully administered consignment arrangements can serve as a useful way to bridge these two competing considerations.

Under a consignment arrangement, the supplier delivers goods to its customer, but maintains title until the goods are either used by the customer in a further manufacturing process or sold by the customer to a third party, at which point title to the goods becomes vested in the customer (if only for an instant in the case of a sale to a third party). Consequently, the customer does not typically pay for the goods until the point at which title transfers – the point of use or sale of the goods by the customer.

This arrangement can benefit both the supplier and customer. The supplier's credit concerns are significantly mitigated because the supplier maintains title to the goods while they are held in inventory on the customer's premises. Similarly, the customer enjoys the ability to stock inventory without having to take on additional credit obligations and other costs of ownership of the inventory prior to resale or use, making the supplier's goods more attractive than similarly priced competing products and increasing the supplier's sales opportunities.

Consignment arrangements are not a panacea, however. They do present risks and traps for the unwary. The rights of consignment suppliers vis-à-vis the rights of third party secured creditors are governed by Article 9 of the Uniform Commercial Code, which treats consignment arrangements in a manner similar to the treatment of purchase money security interests in inventory. If a supplier of goods on consignment fails to take the required steps to protect its interest in the goods or fails to give notice to the customer's existing secured creditors, the goods may fall subject to a pre-existing secured creditor's lien on the customer's inventory. In such a situation, the supplier will find its ownership interest in the consigned inventory junior in priority to existing liens on the customer's inventory.

The result may be devastating to the supplier. If a customer files for protection under the bankruptcy code and has a pre-existing secured creditor with a blanket lien on its inventory, a consignment supplier that has failed to properly perfect and protect its interest in the consigned goods will find that upon delivery those goods became subject to the secured creditor's lien on the customer's inventory. If the customer's assets subject to the liens are insufficient to satisfy the customer's obligations to the secured creditor, the supplier's consigned inventory will be sold and the supplier will not receive any recovery.

Before delivering consigned inventory to a customer, a supplier should consider taking steps to properly perfect and maintain its interest in the goods, including:

- Negotiating and executing a consignment agreement with the customer consistent with the requirements of Article 9 of the Uniform Commercial Code.
- Filing a properly completed UCC-1 financing statement in the appropriate jurisdiction.
- Performing a search for other financing statements indicative of liens against the customer's inventory.
- Providing proper notification of the consignment arrangement to existing secured creditors with liens against the customer's inventory.

Taking these precautions prior to delivering consigned inventory to a customer can help protect a consignment supplier's rights against those of a third party secured lender.

For more information on consignments, contact John D. Cottingham or Garrett A. Nail

Industry Spotlight

IPO Outlook for Life Sciences Companies Post-JOBS Act

By Faith L. Charles & Heather M. DeGregorio

The Jumpstart Our Business Startups Act (JOBS Act), signed into law on April 5, 2012, provides for certain changes to the initial public offering (IPO) process, as well as ongoing reporting requirements, for an issuer that qualifies as an emerging growth company (EGC). The amendments to the federal securities laws related to EGCs are intended to encourage qualifying companies to enter U.S. public capital markets by easing the costs and burdens related to going public and of being a public company for up to five years after an EGC's IPO. The legislation's proponents in the life sciences industry believe that the amendments should encourage life sciences companies to enter the public markets by allowing them up to five years to focus on critical research and product development before having to divert funds to costly compliance with regulations. However, some critics doubt that the JOBS Act will do much to attract additional investor interest in life sciences companies or increase the number of IPOs in the industry.

The JOBS Act defines an EGC as a company with less than $1 billion in annual revenue during its most recent fiscal year. An issuer that qualifies as an EGC will retain such status and the related reduced reporting requirements until the earliest of:

- The end of the fiscal year in which annual revenue exceeds $1 billion.
- The end of the fiscal year in which the fifth anniversary of the issuer's IPO occurs.
- The date on which the issuer has, during the previous three-year period, publicly or privately issued more than $1 billion in non-convertible debt.
- The date on which the issuer qualifies as a "large accelerated filer."[1]

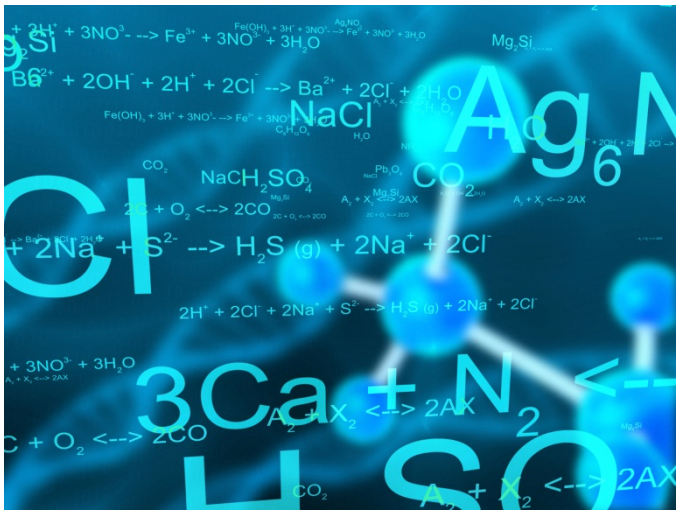
An existing public company can qualify as an EGC if it completed its first registered sale of common equity after December 8, 2011, permitting such company to file its next periodic report under the Securities Exchange Act of 1934 (Exchange Act) using the scaled disclosure applicable to EGCs.

The JOBS Act amends certain provisions of the Securities Act of 1933 (Securities Act) to relax the IPO process for EGCs by:

- Requiring issuers to provide two rather than three years of audited financial statements (and the related Management's Discussion & Analysis of Financial Condition and Results of Operations (MD&A) disclosure and selected financial data for such period) in their registration statements.
- Providing that issuers may comply with the more limited executive compensation disclosures of Item 402 of Regulation S-K applicable to smaller reporting companies in their registration statements.
- Lifting the restriction on communications to potential investors ahead of a public securities offering filing, provided such potential investors are qualified institutional buyers or institutional accredited investors (referred to as "testing the waters").
- Permitting research analysts to publish research reports prior to or during the IPO process, even if the investment bank with which the research analyst is associated is an underwriter in the IPO.
- Permitting an EGC to submit its registration statement and any amendment to the SEC confidentially until 21 days before commencing the road show.
- Deferring compliance with new or revised accounting standards issued after the enactment of the JOBS Act until those standards are applicable to private companies.
- Exempting EGCs from compliance with Public Company Accounting Oversight Board (PCAOB) rules regarding expanded auditor reporting or audit firm rotation, or any new PCAOB rules issued after the enactment of the JOBS Act, unless the SEC determines compliance with such rules is necessary for investor protection.

[1] A "large accelerated filer" is an issuer with a public equity float of at least $700 million that has been a public reporting company for at least one year and that has filed at least one annual report with the Securities and Exchange Commission (SEC).

The JOBS Act also amends certain provisions of the Exchange Act to ease the burden of ongoing public company reporting requirements by exempting EGCs from requirements to hold stockholder advisory votes on executive compensation and golden parachute compensation; disclose the relationship between executive compensation and the financial performance of the issuer, and the ratio of total CEO compensation to the median total compensation of the issuer's employees; and comply with Section 404(b) of the Sarbanes Oxley-Act of 2002 (SOX) requiring auditor attestation on an issuer's internal control over financial reporting. Also, in any subsequent registration statement or periodic report, EGCs are only required to comply with the executive compensation disclosures of Item 402 of Regulation S-K applicable to smaller reporting companies and provide selected financial data covering periods after the earliest audited period in their IPO registration statements (and the related MD&A disclosure and selected financial data for such periods). So long as an issuer maintains its status as an EGC, it will also be permitted to continue to defer compliance with new or revised accounting standards and will remain exempt from compliance with certain PCAOB rules, as discussed above.



While the JOBS Act is seen as the most significant relaxation of IPO and public company reporting requirements in recent times, some are skeptical as to its practical impact on the number of life sciences companies that will go public in 2012 and beyond. In 2011, only seven life sciences companies went public, down from just 13 in 2010.[2] The changes to the IPO process may encourage small companies in the life sciences industry to enter the public markets by reducing expenses associated with preparation of offering materials, as well as decreasing the time it takes to go to market. The confidential filing process may also eliminate anxiety over disclosing sensitive business information while in registration and the potential embarrassment if the registration statement is subsequently withdrawn. Smaller companies in the industry may also be more willing to consider an IPO, given the ability to gauge investor interest in the offering prior to or during the registration process through pre-marketing, thereby avoiding the expense of an offering, which may be unsuccessful, and the possibility of having to withdraw a publicly filed registration statement. Underwriters may prefer not to engage in pre-marketing activities, however, as prospectus liability under Section 12(a)(2) of the Securities Act would still attach to any oral or written statements made.

While changes resulting from the JOBS Act may make going public more palatable for small companies in the industry, it is unclear how the appetite of investors will be affected. For an industry already losing interested investors to other types of technology and social media IPOs, investment banks may advise issuers that a decrease in the quality of disclosure could be detrimental to a successful offering. However, the cost savings associated with the scaled reporting requirements applicable to EGCs may attract some investors who previously were discouraged from investing in a company taking on the expense of being public with a product still in the early developmental stages. The two most significant cost savings associated with the scaled disclosure for EGCs are the elimination of the requirement to comply with Section 404(b) of SOX, which for a company with a public float of $250 million to $700 million is estimated to be more than $1.2 million per year,[3] and certain of the executive compensation disclosures of Item 402 of Regulation S-K.

[2] The statistics in this article related to initial public offerings of life sciences companies in the last five years are based on an analysis of those companies that have completed a public sale of common equity using Form S-1 with one of the following designated SEC SIC codes: 2833, 2834, 2835, 2836, 3826, 3827, 3829, 3841, 3842, 3845 and 3851. The analysis does not include issuers that became reporting companies due to a large shareholder base, which may also qualify as EGCs under the JOBS Act.

[3] *See* "Study and Recommendations on Section 404(b)," Securities and Exchange Commission, April 2011.

Approximately 55 percent of the life sciences companies that have gone public in the past five years were either non-accelerated filers or smaller reporting companies as of their first annual report for which an auditor attestation as to internal control over financial reporting would have been required, and were therefore exempt from such requirement pursuant to SOX.[4] The elimination of the auditor attestation requirement would have represented a significant savings, however, for the approximately 36 percent of issuers during the same period that were required to include the report.[5]

In addition, less than 40 percent of those life sciences companies that have gone public in the last five years qualified as smaller reporting companies able to benefit from the existing scaled executive compensation disclosure requirements of Item 402 of Regulation S-K.[6] The JOBS Act will allow more issuers in the industry to take advantage of the scaled executive compensation disclosure applicable to smaller reporting companies, which eliminates the costly and time consuming preparation of a Compensation Discussion & Analysis, reduces from five to three the number of executives for whom compensation disclosure must be provided and decreases from three to two the number of years for which such disclosure must be provided, in connection with an issuer's annual report.

While, as of June 7, 2012, 19 companies in the industry that either went public after December 8, 2011 or were in the registration process when the JOBS Act was passed have made filings disclosing their status as EGCs, the JOBS Act provides issuers with the option to avail themselves of some or all of the scaled disclosure provisions (except that issuers may not selectively comply with new accounting standards). Many issuers may choose to or be advised by their investment bankers to include one or more items of disclosure EGCs are now permitted to exclude in order to enhance the marketability of their offerings. In particular, an April 2011 study by the SEC found that investors generally view the auditor's attestation on internal control over financial reporting as beneficial.[7] Underwriters and issuers may also be reluctant to take advantage of scaled disclosure in some instances, given the continued applicability of the general liability provisions of the federal securities laws. The SEC has suggested that the omission of financial information that shows a negative trend or that is related to a prior significant transaction, even if no longer required to be disclosed, may be material to an investor's understanding of the business, and therefore should be included in the IPO registration statement. This is less likely to arise in the context of the IPO of a small life sciences company, however, given that most of these issuers have little or no product revenue prior to the offering.

Whether the amendments made by the JOBS Act to the federal securities laws will encourage more life sciences companies to enter the U.S. public markets remains unclear and, given the provision for confidential filing of registration statements, may take some time to assess. It is also unclear whether investment banks taking on underwriter liability in connection with a securities offering will be willing to change their existing disclosure standards and pre-deal marketing policies. Most importantly, it remains to be seen whether investors will be willing to sacrifice more extensive disclosure for the diversion of offering proceeds from regulatory compliance costs to a promising life sciences company's developing product or technology.

For more on Life Sciences, contact Faith L. Charles or Heather M. DeGregorio

[4] *Supra* note 4.

[5] Every life sciences company whose IPO was reviewed in connection with this article would have qualified as an EGC. *See supra* note 4.

[6] Such issuers, as smaller reporting companies, would have also already been eligible to provide only two years of audited financial statements (and the related MD&A disclosure for such period) and would not have been required to provide selected financial information.

[7] *Supra* note 4.