

## Message from Our Office

Pepper's Boston office continues growing: we've recently welcomed corporate and securities law partner **Gene T. Barton, Jr.** and intellectual property law associate **Frank D. Liu**. Mr. Barton's practice emphasizes financing and merger and acquisitions activity. He represents emerging companies and venture capital and other private equity funds, and provides general corporate, business planning and financial advice to public and private companies. Mr. Liu concentrates his practice in intellectual property, bringing to bear his education in mechanical engineering.

In this issue, we turn to business and financial matters. We report on a landmark case Pepper argued (and prevailed in) before the ITC, helping a client assert, then sell, its patent rights. Roger Lane and Courtney Worcester provide risk management tips for venture capitalists, and Matt Gilman reports on the SEC's approval of modified continued listing requirements for NASDAQ-listed companies.

Online, Pepper has partnered with The Deal on a podcast series and our first edition explores midmarket pharma and health care deals, and we note the latest offerings among Pepper's Indian Series, Canadian Series, health care and life sciences webinars.

We always welcome your comments, questions and suggestions.

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## Patent Owners Find Protection in Landmark Case Argued Before ITC by Pepper Hamilton

### *Legal Victory Accelerated the Sale of Saxon Innovations LLC*

Pepper Hamilton LLP has prevailed in a cast that led to a recent ruling by the International Trade Commission (ITC) that will have major implications for companies that license their patent portfolios to U.S. businesses.

"This is an important ruling that significantly impacts technology companies who license their patent portfolios, as well as venture capital and private equity firms with portfolio companies that hold valuable patents," said William D. Belanger, a partner in Pepper's Boston office. "The ruling gives patent owners greater flexibility to enforce their intellectual property and may result in more case filings at the ITC."

The ITC has become an important venue for patent disputes because of its power to issue orders barring the importation of goods that infringe on U.S. patents. A 2006 Supreme Court ruling made it much more difficult to obtain broad injunctions against infringing goods in federal court, so increasingly patent holders are turning to the ITC for relief. However, very few practitioners are experienced in the rules and requirements of litigation before the ITC. Pepper is one of those few firms.

To win a patent dispute before the ITC, the plaintiff must establish a domestic industry related to the patent at issue. The ruling in *Certain Electronic Devices Including Handheld Communications Devices*, (Inv. 337-TA-673 and 337-TA-674), which caused ripples in the intellectual property field, held that patent owners can fulfill the domestic industry requirement based exclusively on the activities of their domestic licensees.

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Pepper attorneys, representing Saxon Innovations LLC, filed a complaint for patent infringement against prominent international technology companies, including Samsung, Nokia, HTC, Palm and Sharp.

“One key issue in this case centered on establishing a domestic industry related to the patent. Typically, parties satisfy the domestic industry requirement by pointing to an existing factory or R&D facility that employs the patented technology,” said Aaron Levangie, an associate in Pepper’s Boston office. “In Saxon’s case, we focused on domestic companies who licensed the asserted patents, and those licensee’s activities exploiting the patented technology in the United States.” The ITC ultimately ruled in favor of Saxon, creating an opportunity for patent owners who have licensed their portfolios to domestic companies.

“Pepper Hamilton helped manage this opportunity for us from the initial acquisition through the sale of the asset. This was a complex IP monetization program, and required a truly sophisticated partner, which they proved to be,” said Bill Marino, CEO of Saxon Innovations. “Pepper’s ITC expertise, combined with their industry knowledge and ability to manage this program on an alternate fee basis, was critical to our company’s success.”

“Our success at the ITC ratified the value of Saxon’s patent assets and Pepper’s work in obtaining this ruling and at trial was key in driving the sale,” said Marino. “For such a major transaction, this deal was finalized in a remarkably short timeframe. The value of the patent sale was increased by Pepper’s seamless representation on litigation and transaction matters, as well as the ITC’s willingness to protect Saxon’s domestic licenses.”



## The Deal and Pepper Hamilton’s Legal Roadmap to Success - Midmarket Pharma, Health Care Deals

There are a number of hot-button legal topics interesting to dealmakers at the moment. What key legal issues should you be thinking about in the coming months? Hear thoughtful perspectives in this series of incisive podcasts from The Deal and Pepper Hamilton LLP.

# The Deal

### EPISODE 1: PEPPER HAMILTON ON MIDMARKET PHARMA, HEALTH CARE DEALS

Pharma and health care deals seem to have remained recession-proof. As the economic environment improves, Pepper Hamilton partners Christopher S. Miller and John W. Jones, Jr. believe dealmaking in the sector is likely to pick up. In this podcast sponsored by Pepper Hamilton, the two discuss the larger issues facing the industry and how they will affect dealmaking.

Listen today by visiting

[www.thedeal.com/knowledge/podcasts/pepper-hamilton-on-midmarket-pharma-healthcare-deals.php](http://www.thedeal.com/knowledge/podcasts/pepper-hamilton-on-midmarket-pharma-healthcare-deals.php).

# Top Five Risk Management Tips for Venture Capitalists

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The modern U.S. venture capital industry had its first flowering in the 1970s, in fields that lay fallow after a stiff recession. Since that time, by many accounts, the U.S. economy has been in nine more recessions, of varying magnitude and duration, including the one that we're told we're presently recovering from.

As corporate litigation and risk management lawyers, it's not our place to assess the most recent recession relative to others, except to note the obvious: It has been severe, and asset values have been materially reduced across the board. Signs of a recovery are emerging, but any recovery is still expected to be gradual and halting.

Our job in this context is to look ahead and identify practical protective steps that venture capital firms can take to reduce litigation risk, and to better position themselves for the favorable disposition of any disputes that may nonetheless arise from corporate finance and other transactions undertaken in this environment. The simple fact is that deals done in downturns are far more likely to result in stockholder disputes and lawsuits down the road—after asset values have recovered and hindsight and second-guessing have set in. How do VC firms best protect their interests?

Here are our top five suggestions for reducing that risk:

## 1. MIGRATE ... TO DELAWARE

All of a firm's portfolio companies should be Delaware corporations. In our view, there is no advantage to incorporating elsewhere that withstands thorough analysis. This is an exceedingly simple point, but it is of key importance from a risk management perspective.

There are four basic reasons that support this statement: Delaware corporate law is far better developed than that of any other state; the judiciary is of consistently high quality; legal outcomes, while never guaranteed, are consequently more predictable and more certain; and, the personal assets of individual directors and stockholders are better protected.

So, if the firm has portfolio companies that are not Delaware-incorporated, and a significant transaction is anticipated, such as a debt or equity financing, recapitalization or restructuring, consider also conducting a migratory merger to Delaware. For experienced counsel, a migratory merger is a relatively simple exercise, particularly if the firm can fairly anticipate a favorable stockholder vote. In addition, in the context of a significant transaction, the incremental effort is relatively modest. The benefits, however, can be substantial.

One detail, all too often overlooked, is that from a risk management perspective, an effective migratory merger consists of more than the adoption of a Delaware corporate charter; in addition, the various stockholder agreements also need to be amended in parallel—to call out Delaware as the governing law, and its Court of Chancery as the forum for resolving disputes. Otherwise, there is risk of having pointless “sideshowes” about what law actually governs a particular dispute, what court has authority to resolve that dispute, and so forth.

## 2. INVITE EVERYBODY TO THE PARTY

The basic rules of childhood once again prove their durability. If a portfolio company is undergoing a down-market financing or recapitalization, consideration should be given to inviting all accredited investors to participate on the same terms—regardless of whether they have express contractual rights of participation.

Offering such participation protects venture firms and corporate directors in two ways. If a stockholder cannot confirm accredited investor status, it is difficult to blame anyone when the law does not permit that stockholder to play. In addition, it is far more difficult for disgruntled stockholders to claim unfair dilution if they were invited to participate on the same terms as others and, for whatever reason, they elected not to do so. In most instances, the marginal dilutive effect on the professional investors who are providing the bulk of the new money will be immaterial.

## 3. UPGRADE COMPANY INFRASTRUCTURE

“Infrastructure reinvestment” is one of the hallmarks of the current administration's plan for the nation's economic recovery. The concept applies to portfolio companies, as well. There is no better time to inspect and upgrade infrastructure than right now.

Two elements of portfolio company infrastructure stand out as having the most meaningful impact on risk management: an adequate finance and accounting function, and a properly composed board of directors.

The entire process of seeking portfolio company liquidity—be it an IPO or, more likely, an M&A transaction—will be significantly enhanced if the company has consistently maintained an accounting and finance function adequate to meet its needs throughout its development.

The term “enhanced” does not simply mean that the process will go more smoothly. It also means a significant reduction in the risk of uncovering errors, omissions and irregularities that can negatively impact valuation, derail negotiations altogether, or cause the company to miss a market window.

Literally months can be consumed in “diligencing” accounting issues after the fact and preparing fresh financial statements. Inquire into the adequacy of these functions at your more mature, revenue-generating portfolio companies, where the issue is most likely to have a material impact: Does the company have personnel with the requisite knowledge and experience for the tasks at hand? Is the accounting and finance function adequately staffed? What do the auditors say?

Similarly, review the composition of the boards of directors of the firm’s more mature portfolio companies. Does each board have at least two independent, outside directors? Are the boards of the companies that are closest to a liquidity event composed of a majority of independent outside directors? If not, are candidates available, or can they be found?

Why the preoccupation with board composition? Because corporate transactions and events undertaken in a recession—down-round financings, recapitalizations, executive terminations and the like—are often driven by, or at least perceived to be driven by, existing investors holding one or more board seats, who are then invariably claimed to have acted out of self-interest.

Risk management in this context, where corporate and stockholder interests may diverge and conflict, is about vesting the corporation’s authority and decision in the hands of competent and disinterested fiduciaries. Two or more disinterested outside directors can comprise an independent board committee, or a majority of disinterested directors can act for the board, provided that each is truly independent and has no material personal interest in the challenged decision.

#### 4. SWIM IN THE MAINSTREAM

Terms of VC financings, like any commercial terms, evolve through economic cycles. In the most recent recession, there has been renewed or expanded use of multiple liquidation preferences, participating preferred, and preferred stock redemption terms; an increased reluctance to waive anti-dilution rights; and an increased use of “pay-to-play” provisions. Venture firms and their advisors will have differing views on the positive and negative aspects of such provisions, the details of their terms, and counter-balancing pro-company and pro-management terms.

However, all of these lie within the mainstream of the current deal-making dialogue. In this context, firms should be cautious if they wish to step substantially beyond existing market terms, at least absent a company-specific business or finance rationale. Terms that are substantially beyond market norms are more likely to draw complaints in the first instance, as “outliers,” and may prove more difficult to defend for the same reason.

#### 5. DON’T BLOW YOUR COVER(AGE)

Last but not least, the liability protection provided to a venture capital firm and its personnel via indemnification provisions and insurance coverage should be reviewed at both the portfolio company and fund level. Each portfolio company should, as a matter of course, provide its directors with indemnification. Given the present litigation environment, we believe that each company should also maintain a directors’ and officers’ liability policy to back up those indemnification obligations. In addition, those D&O policies should be reviewed by competent personnel to ensure their adequacy, because fundamental errors can be made in such policies.

Further, if you have not done so, consider whether your firm should have its own professional liability insurance policy. Coverage for venture capital firms is not cheap, but it has proven worthwhile for firms with large portfolios and mature portfolio holdings. Finally, consider whether to seek fund indemnification. Your firm’s money has been invested in its portfolio companies, and it is not unreasonable to request that a part of those funds be available for indemnification if claims later arise. VC liability policies often come with substantial retentions (i.e., deductibles), and fund indemnification is one means of financing that retention.

## SEC Approves Modified Compliance Periods and Procedures for Certain Continued Listing Requirements of NASDAQ-Listed Companies

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On January 29, 2010, the U.S. Securities and Exchange Commission (SEC) approved proposed rule changes to modify the length of certain compliance periods in NASDAQ's continued listing requirements and to modify the time available for a company to provide a plan to regain compliance with certain continued listing requirements.<sup>1</sup>

Specifically, the amended rules:

- extend the period of time, from 10 to 30 consecutive trading days, that triggers a company's non-compliance with the minimum market value of listed securities continued listing requirement
- extend the period of time, from 90 to 180 calendar days, a company has to regain compliance with the continued listing requirement regarding the minimum market value of its publicly held shares
- extend the period of time, from 90 to 180 calendar days, a company has to regain compliance with the continued listing requirement regarding the minimum market value of its listed securities
- increase the number of calendar days, from 15 to 45, that a company has to present its plan to regain compliance with applicable continued listing requirements
- increase the length of time NASDAQ staff can grant to a company to regain compliance with applicable continued listing requirements, from 105 to 180 calendar days.

### PRICE-RELATED CRITERIA

All companies listed on NASDAQ are required to maintain a minimum market value of their publicly held shares. Companies listed on the Global and Global Select Markets must maintain either a \$5 million or \$15 million market value of publicly held shares, and companies listed on the Capital Market must maintain a \$1 million market value of publicly held shares.<sup>2</sup>

In addition to the requirement of maintaining a minimum market value of publicly held shares, companies listed on NASDAQ that qualify for continued listing based on the "Market Value of

THE AMENDED RULES ALSO MODIFY THE TIME PERIODS APPLICABLE IN CASES IN WHICH THE COMPANY IS PERMITTED TO PROVIDE NASDAQ STAFF WITH A PLAN TO REGAIN COMPLIANCE WITH CERTAIN CONTINUED LISTING STANDARDS, AND MODIFY THE TIME PERIOD IN WHICH NASDAQ STAFF CAN GRANT AN EXTENSION OF TIME TO REGAIN COMPLIANCE FROM ITS INITIAL NOTIFICATION OF NON-COMPLIANCE TO THE COMPANY.

Listed Securities Standard" are required to maintain a minimum market value of listed securities of \$50 million in the case of companies listed on the Global or Global Select Markets, or \$35 million in the case of companies listed on the Capital Market.<sup>3</sup>

Before the adoption of the new rules, a listed company was considered to be non-compliant with continued listing standards if the market value of the company's publicly held shares fell below the applicable standard for 30 consecutive trading days. Upon such failure, the company was provided with 90 calendar days to regain compliance. Further, a company that qualified for continued listing based on the Market Value of Listed Securities Standard was considered to be non-compliant after falling below the applicable minimum market value of listed securities standard for 10 consecutive trading days, following which the company was provided 90 calendar days to regain compliance with the applicable standard.

In its proposed rule, NASDAQ noted that under its minimum bid price continued listing standard, if a company's security has a closing bid price below \$1 for 30 consecutive trading days, then it no longer meets the bid price requirements and is automatically provided 180 calendar days to regain compliance. NASDAQ asserted that because compliance with (i) the minimum bid price, (ii) the minimum market value of publicly held shares, and (iii) minimum market value of listed securities are all directly related to the price of an issuer's security, the length of time to trigger non-compliance and the amount of time afforded to regain compliance should be consistent.

The amended rules now make consistent the time periods that trigger companies' non-compliance in these three areas (minimum bid price, the minimum market value of publicly held shares, and minimum market value of listed securities) and make consistent the amount of time afforded companies to regain their compliance, by extending the length of time to trigger non-compliance with the minimum market value of listed securities requirement from 10 to 30 consecutive trading days, and extending the amount of time afforded to regain compliance with each of the minimum market value of publicly held shares and the minimum market value of listed securities from 90 to 180 calendar days.<sup>4</sup>

#### MODIFIED TIME PERIODS TO SUBMIT PLAN TO REGAIN COMPLIANCE

The amended rules also modify the time periods applicable in cases in which the company is permitted to provide NASDAQ staff with a plan to regain compliance with certain continued listing standards, and modify the time period in which NASDAQ staff can grant an extension of time to regain compliance from its initial notification of non-compliance to the company.

Before the adoption of the new rules, if a company had certain deficiencies from the continued listing standards, such as quantitative deficiencies from standards that do not provide for a compliance period (e.g., the minimum requirements for stockholders' equity, total assets and total revenue, net income from continuing operations, the number of publicly held shares or the number of shareholders), the company had 15 calendar days to submit a plan to regain compliance.<sup>5</sup> Following a review of the compliance plan, NASDAQ staff could grant the company a period of up to 105 calendar days from the initial notification of non-compliance for the company to regain compliance.

The amended rules increase the number of calendar days a company has to present its compliance plan from 15 to 45 (and also permits NASDAQ staff to grant an extension of this period of up to five days, if good cause is shown) and increase the length of time that the NASDAQ staff can grant to a company to regain compliance from its initial notification of non-compliance, from 105 to 180 calendar days. In amending the rules, NASDAQ noted that 15 days is often insufficient for a company to prepare a meaningful compliance plan, especially in light of current market and economic conditions, and that allowing companies additional time from its initial notification of non-compliance will better allow companies to implement their plan to regain compliance.<sup>6</sup>

#### IMPLEMENTATION

The amended rules have the following transition implications:

- any company that was not notified that it was non-compliant with the market value of listed securities continued listing requirement upon the SEC's approval of the amended rules, will not be notified until they have fallen below the requirement for 30 consecutive trading days from the initial date of non-compliance
- any company that was notified prior to the approval of the amended rules that it was non-compliant with either the market value of listed securities or the market value of publicly held shares continued listing requirement and that is still within the 90-calendar day compliance period for such failure will have their compliance period extended until 180 days from the date they were originally notified of the deficiency
- with respect to the compliance plan process, if a company has not submitted its plan of compliance when the amended rules were approved, the deadline to submit that plan will be extended until 45 days from the date of the NASDAQ staff's notification of the deficiency
- if a company had already submitted its plan of compliance when the amended rules were approved, but NASDAQ staff has not yet determined whether or not to grant additional time, the staff will be permitted to grant the company up to 180 days from the date of the NASDAQ staff's notification of the deficiency, and

- if a company had already received an extension of time to regain compliance when the amended rules were approved, at the end of that extension the staff could, based on a review of the company at the time, grant additional time for the company to regain compliance, up to 180 days from the staff's original notification of the deficiency.

#### ENDNOTES

- <sup>1</sup> For continued listing, NASDAQ requires listed companies to meet specific quantitative requirements and stringent corporate governance standards. A listed company may satisfy the continued listing requirements of the NASDAQ Global Select Market, the NASDAQ Global Market or the NASDAQ Capital Market, as the case may be, by satisfying the criteria under at least one of three standards applicable to each market. These standards, known as the "Equity Standard," "Market Value of Listed Securities Standard" and the "Net Income Standard," can be found at [http://www.nasdaq.com/about/nasdaq\\_listing\\_req\\_fees.pdf](http://www.nasdaq.com/about/nasdaq_listing_req_fees.pdf).
- <sup>2</sup> "Publicly held shares" means the total shares outstanding, less any shares held directly or indirectly by officers, directors or any person who is the beneficial owner of more than 10 percent of the total shares outstanding of the company.
- <sup>3</sup> "Listed securities" means securities listed on NASDAQ or another national securities exchange.
- <sup>4</sup> As amended, the maximum amount of time that could be afforded to a company that failed to meet the market value of listed securities or market value of publicly held shares requirement would be 18 months. A company would only receive an extension up to this 18-month maximum length if (i) it failed to comply during the automatic 180-day compliance period, (ii) the company appealed to a NASDAQ Hearings Panel, and (iii) the NASDAQ Listing and Hearings Review Council determined to call the matter for review, to stay the company's delisting, and, after reviewing the company's compliance plan, to provide the company with the maximum 360-day period from the date of the Staff Delisting Determination to regain compliance.
- <sup>5</sup> See NASDAQ Rule 5810(c)(2) for a more comprehensive list of deficiencies for which a company may submit a plan of compliance to NASDAQ staff.
- <sup>6</sup> The maximum amount of time that could be afforded to a company that failed to meet a listing requirement that allows the submission of a plan to regain compliance would be 18 months. See endnote 4.

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## Upcoming Webinars

### INDIAN WEBINAR SERIES: HIDDEN EMPLOYMENT LAW RISKS IN DOING BUSINESS IN THE UNITED STATES

Wednesday, March 24, 2010

11:00 A.M. - 12:00 P.M. Eastern

### DUMPING PHARMA

Health Care Legal Issues for 2010 and Beyond Webinar Series

Thursday, March 25, 2010

12:00 - 1:00 P.M. Eastern

### CRITICAL CONSIDERATIONS IN DISTRESSED M&A TRANSACTIONS: EXPLORING RISKS AND OPPORTUNITIES

Wednesday, April 7, 2010

12:00 - 1:00 P.M. Eastern

### HEALTH CARE PRIVACY AND SECURITY AFTER HITECH

Health Care Legal Issues for 2010 and Beyond Webinar Series

Thursday, April 22, 2010

12:00 - 1:00 P.M. Eastern

### CANADA-U.S. TRADE UPDATE LUNCHEON

Canadian Webinar Series

Thursday, April 29, 2010

12:00 - 1:00 P.M. Eastern

### SOLAR POWER FOR END USERS - WHERE TO STORE?

Thursday, May 6, 2010

12:00 - 1:00 P.M. Eastern

### LEASE CONSIDERATIONS FOR GREEN BUILDING

Wednesday, May 19, 2010

12:00 - 1:00 P.M. Eastern

### GREEN BUILDING FOR OWNERS AND DEVELOPERS

Wednesday, June 9, 2010

12:00 - 1:00 P.M. Eastern

To register or for more information about these webinars, please visit the webinar section of [www.pepperlaw.com](http://www.pepperlaw.com) or contact Brian Dolan at [dolanb@pepperlaw.com](mailto:dolanb@pepperlaw.com) or at 215.981.4568.