

Message from Our Managing Partner

We welcome Harry P. (Hap) Weitzel, who concentrates his practice on civil trials and arbitrations, as he joins Pepper's Orange County office as a partner in the firm's Commercial Litigation Practice Group.

Also in this issue, we tackle a myriad of issues in the boardroom, navigate holiday parties, consider the fate of the planet, and more.

Valérie Demont's article examines all the considerations necessary when deciding "to be or not to be a public company," amid signs of revival of the U.S. capital markets: a flurry of IPO activity unseen since the beginning of the credit crisis.

Next, Jane Luxton and Bill Walsh examine how the Second and Fifth Circuits recently issued surprising rulings that allow public nuisance tort lawsuits to go forward on theories related to climate change.

In a Pepper podcast, Amy McAndrew discusses labor and employment pitfalls of company holiday parties. It's more than just lampshades on heads – eat, drink and be wary, she advises, in matters such as gift-giving, holiday bonuses and more. Listen today by visiting the Labor and Employment Law section of www.pepperpodcasts.com.

Sharon R. Klein, Partner

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Harry P. Weitzel Joins Pepper's Commercial Litigation Practice

Harry P. (Hap) Weitzel has joined Pepper's Orange County office as a partner in the firm's Commercial Litigation Practice Group.

Mr. Weitzel concentrates his practice on civil trials and arbitrations. He has successfully represented individual, corporate and governmental clients, as plaintiffs and defendants, in a wide variety of matters, including contract and business tort litigation, fiduciary litigation, ERISA litigation, malpractice, product liability, construction disputes, securities litigation, intellectual property disputes, employment litigation, trade secrets litigation, defamation suits, consumer class actions, franchise litigation, environmental litigation, insurance coverage disputes, real estate litigation, stock option litigation, and antitrust. Mr. Weitzel has tried cases in state and federal courts, as well as arbitrations under the AAA and ICC. He has handled appeals in state and federal courts.

Sharon R. Klein, partner in charge of our Orange County office, said, "The firm is committed to fully developing our California presence. Bringing someone on board like Hap reinforces that dedication and strengthens our ability to provide clients the services they have come to expect from Pepper nationally."

Amy B. Ginensky, chair of Pepper's Commercial Litigation Practice, added, "Hap is a great addition to our group. He brings with him a wealth of trial experience that will help expand our litigation practice in California."

Prior to joining Pepper, Mr. Weitzel practiced with firms in California and Texas.

"I'm excited by the opportunity to work with such a talented group of lawyers and am confident that together we can offer our clients unsurpassed representation," said Mr. Weitzel.

This publication may contain attorney advertising.

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To Be or Not to Be a Public Company

VALÉRIE DEMONT | DEMONTV@PEPPERLAW.COM

THIS ARTICLE WAS PUBLISHED IN THE DECEMBER 9, 2009 ISSUE OF *THE DEAL MAGAZINE*, AND IS REPRINTED HERE WITH PERMISSION.

A flurry of initial public offering activity, which had been unseen since the beginning of the credit crisis, indicates a further sign of revival of the U.S. capital markets. The new IPOs should be good news to many companies that had been effectively shut out of various financing sources — debt and equity — over the past year. This year, more than 55 companies have filed IPO registration statements with the U.S. Securities and Exchange Commission. Most are U.S. companies, joined by a few foreign companies, especially from China. Many of them are REITs and technology-based services providers, with a few in the financial services, power, retail and other sectors. About 23 companies effectively completed their IPOs this year, a far cry from 2007's 282 IPOs or even 2008's 51 IPOs, but the recent increase in the number of IPO filings over the past few weeks is cause for optimism.

An IPO is a transformational event for a company, its management, employees and promoters, and the decision to go public is one that needs to be carefully weighed.

For promoters, an IPO may allow them to monetize their investment by selling down a portion of their holdings in the company at the time of the IPO, yet at the same time retain control of the company. Once the company is public, promoters may also find it easier to sell portions of their ownership over time in additional sales into the public markets.

For companies, an IPO allows them to access, in at times significant amounts, additional capital; raise their profile in the industry and with their clients; facilitate acquisitions and other M&A activity (publicly traded stock can be an attractive alternative to cash); in certain cases, obtain better loan terms from lenders; and give them additional incentives to attract and retain top talent. Once public, the company may also regularly tap the public capital markets to raise additional funds on an ongoing basis as its business and funding needs evolve.

These considerations must be carefully weighed against the challenges and costs of going public and ongoing compliance and regulatory burdens applicable to public companies, their direc-

tors, officers and principal stockholders. Some of these challenges and requirements include:

Independent Board. Unless more than 50 percent of the voting power of the company is held by a shareholder following the IPO, a majority of the board of directors will generally need to be independent. The company will also be required to have a fully independent compensation committee and nominating/corporate governance committee (subject to phase-in periods). With the growing demands on independent directors, finding the right independent directors may be a difficult task, and the company will also need to procure director and officer liability insurance to attract new independent directors.

Audit Committees. Public companies are required to have fully independent audit committees, with audit committee members who meet certain financial literacy requirements.

Independent Auditors. The independent auditors of the company will need to be registered with the Public Company Accounting Oversight Board, or PCAOB. This may require the company to change its auditors and get new audited financials in connection with its IPO. The relationship of the independent auditor with management and the company is regulated, and audit committee preapproval of audit and nonaudit services provided by the independent auditors will be required.

Internal Control Over Financial Reporting. Public companies are required to maintain "internal control over financial reporting." Management must carry out an annual assessment of the company's internal control over financial reporting, which, in certain cases, will also need to be passed upon by the company's independent auditors. Those requirements are complex, time-consuming and costly.

Disclosure Controls and Procedures. Public companies must maintain "disclosure controls and procedures" that ensure internal procedures are in place to timely and adequately dispense information to the public. As with internal controls, these disclosure controls are also subject to effectiveness assessments.

Financial Statements. The IPO prospectus will need to contain audited and unaudited consolidated financial statements of the company for the past three years (and any interim quarterly

unaudited financial statements) and selected annual consolidated financial data for the past five years (of which the oldest two years may be unaudited).

Public Scrutiny. Public companies are subject to extensive ongoing reporting, disclosure and other compliance obligations. Among other requirements, the company must make annual and quarterly disclosures as well as ongoing periodic disclosures upon the occurrence of specific events. Those requirements can be difficult when the company is experiencing financial or business difficulties, contemplating a significant transaction, or entering into strategic agreements that it may have to disclose. The company also will become subject to rules regarding shareholders' meetings and proxy statements. In addition, it will need to file its material agreements with the SEC. The SEC standards for confidentiality of competitive and other sensitive information are difficult to meet.

Certifications. The CEO and CFO of the company will need to certify the company's periodic filings. A knowingly false certification could lead to criminal liability.

Loans to Executive Officers and Directors. Any loan or advance extended to directors and executive officers will need to be repaid, forgiven or otherwise unwound as soon as possible prior to the filing of the IPO.

Stockholder Reporting Obligations. Executive officers and directors, as well as 10 percent stockholders, must publicly disclose their securities holdings in the company (including derivative securities). In addition, they must publicly disclose any trades that they make in the company's securities and will be subject to liability for "short-swing" profits they make on any sales and purchases of the company's securities occurring within a six-month period. Separately, any person beneficially owning more than 5 percent of the company's securities must publicly file statements disclosing his or her identity and stock ownership. Violation of these obligations could result in profit disgorgement and other penalties.

Hostile Takeover and Shareholder Activism. Public companies are subject to hostile takeover activity and shareholder activism, both of which are on the rise. Anti-takeover defenses will need to be put in place to protect the continued growth of the business while balancing those needs against a successful marketing of the IPO, the requirements of investors and the positions taken by proxy advisory firms on corporate governance and takeover defenses. For example, opposition is growing against certain

forms of takeover defenses, including poison pills, staggered boards and plurality voting.

Employment and Benefit Plans. Employment agreements for senior management and key employees and employee benefit plans (for example, incentive plans, stock purchase plans and director stock option plans) should be put in place at the time of the IPO for retention purposes, IPO marketing reasons and because it is more difficult to put those plans in place once the company has gone public. These arrangements should comply with the new corporate governance environment on say-on-pay and executive compensation.

Investor Relations. Public companies need to release earnings on a quarterly basis and comply with complex rules on communications. An officer in charge of investor relations and an investor relations firm will need to be hired for that purpose.

Costs. An IPO is an expensive process with underwriter commissions of about 7 percent of the IPO proceeds and legal, accounting, stock exchange and other fees and expenses on top of that. Post-IPO, ongoing compliance and reporting costs can be burdensome, especially for smaller public companies.

Although taking a company public requires much consideration, it can be a very beneficial experience when done correctly. By carefully planning and scrutinizing each step of the process, management and stockholders can ensure that the best interests of the company and its stockholders are being served.

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Second and Fifth Circuits Open the Door to Climate Change Public Nuisance Lawsuits

JANE C. LUXTON | LUXTONJ@PEPPERLAW.COM

WILLIAM J. WALSH | WALSHW@PEPPERLAW.COM

Catching many by surprise, in the last several weeks two federal appellate courts have ruled that public nuisance tort lawsuits may go forward on theories related to climate change. Both the Second¹ and Fifth² Circuits overturned lower court decisions that had rejected this kind of litigation as falling within the “political question” domain that the Constitution directs courts not to decide. There are big hurdles between allowing these lawsuits and reaching a litigated judgment that holds companies that emit greenhouse gases liable for monetary damages allegedly resulting from global warming. However, there is no question that these decisions have the potential to usher in a wave of nuisance suits for damages against virtually any emitter of greenhouse gases.

Of the two decisions, the Fifth Circuit decision in *Comer v. Murphy Oil* is the more sweeping. While the Second Circuit case seeks injunctive relief on behalf of several states and land trusts, the Fifth Circuit litigation was brought by private class action plaintiffs suing under state law for compensatory and punitive damages. The case involves claims by homeowners in Mississippi who argue their property damage from Hurricane Katrina was due to stronger hurricane intensity caused by greenhouse gas emissions from oil, gas, and coal companies, including a number of major oil companies. In allowing the lawsuit to go forward, the Fifth Circuit concluded that the plaintiffs’ theory was not materially different from that relied upon by the Supreme Court in *Massachusetts v. EPA*,³ the landmark decision that required the Environmental Protection Agency to consider whether carbon dioxide is a pollutant under the Clean Air Act: “Thus, the [Supreme] Court accepted a causal chain virtually identical in part to that alleged by plaintiffs, *viz.*, that defendants’ greenhouse gas emissions contributed to warming of the environment, including the ocean’s temperature, which damaged plaintiffs’ coastal Mississippi property via sea level rise and the increased intensity of Hurricane Katrina.”⁴

It is one thing to meet the threshold for establishing standing to maintain a lawsuit, and another thing entirely to win on the merits. As a first step, it is likely that defendants will seek rehearing, in an effort to subject these decisions to consideration

by the full set of Second and Fifth Circuit judges; this will test whether those full Courts of Appeals agree with opinions issued by, respectively, two- and three-judge panels.⁵ Beyond that, a major legal battle lies ahead for the plaintiffs in trying to prove their property losses were caused by the carbon dioxide emissions generated by the defendants, and distinguishing the responsibility those companies may bear for global warming from what is due to emissions contributed by so many other sources. Even if defendants prevail in the end, however, the transaction costs of defending these lawsuits are bound to be significant. And in the meanwhile, there is no analytical distinction between the defendants named in these two recent cases and any other carbon dioxide emitters that the next group of plaintiffs may choose to target. The implications for U.S. businesses are substantial.

ENDNOTES

- 1 *Connecticut v. American Electric Power Co.*, No. 05-5104, 2009 U.S. App. LEXIS 20873 (2d Cir., Sept. 21, 2009).
- 2 *Comer v. Murphy Oil Co.*, No. 07-60756, 2009 U.S. App. LEXIS 22774 (5th Cir., Oct. 16, 2009).
- 3 *Massachusetts v. EPA*, 549 U.S. 497 (2007). EPA is proceeding to develop a series of greenhouse gas regulatory requirements based on the Supreme Court’s mandate.
- 4 *Comer v. Murphy Oil Co.*, slip op. at 23.
- 5 Among other issues, defendants will surely point out that the Supreme Court’s 5-4 decision in *Massachusetts v. EPA* depended heavily on the fact that the plaintiffs in that case were states and had unique standing to raise climate change concerns. While this may make the Second Circuit’s decision in *Connecticut v. American Electric Power Co.*, more likely to be sustained on rehearing, (or on review by the Supreme Court), since *Connecticut* also involves state plaintiffs, it offers much less comfort to the Fifth Circuit’s application of this reasoning to accord standing to private plaintiffs in personal injury tort actions for compensatory and punitive damages.