

Alternative Structures for Life Sciences Companies: The LLC Holding Company

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Presentation Outline

- Overview
- Establishing the LLC Holding Company
- Benefits and Drawbacks of Using the LLC Holding Company Structure
- Timing Considerations
- Summary



Overview: What is Driving the LLC Structure?

- Life sciences companies often have – or envision – multiple programs
- Multiple programs offer possibilities
 - Multiple exits
 - Different funding streams for different programs
- Goal is to realize the maximum value for all programs



The Drawback of the C Corp

- Sale or license of a program results in double taxation if net proceeds are distributed to shareholders
- Sale of the stock of the whole company results in a single level of tax
 - Buyer gets all programs, not just the ones it really wants
 - Little or no value attributed to “other programs”
 - Buyer likely to shut down the unwanted programs
 - Seller and its shareholders cannot realize the value of the other programs



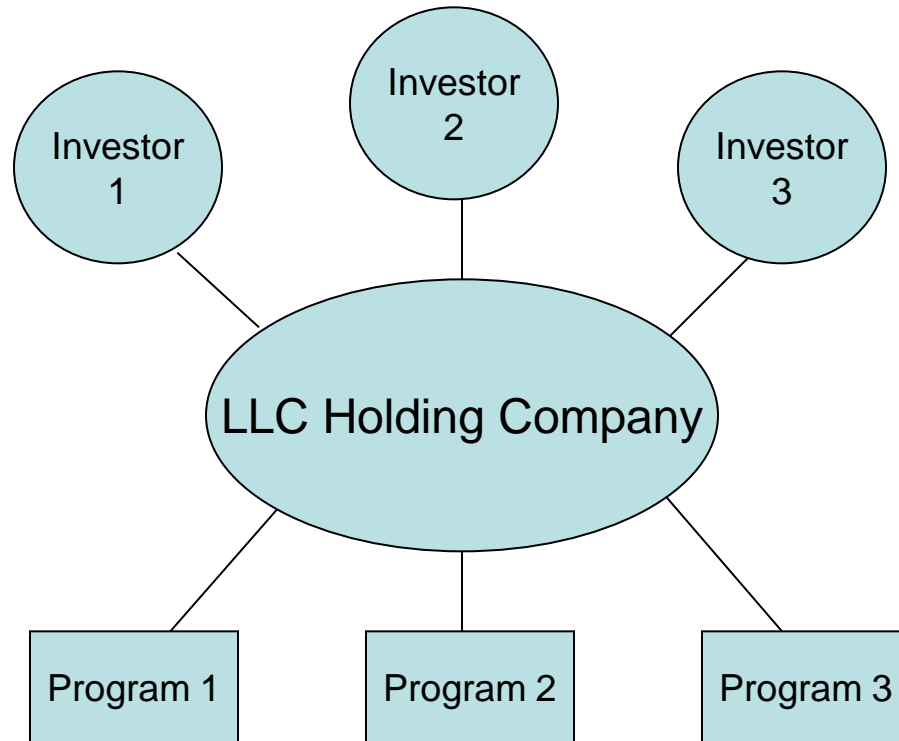
What is the Alternative if Remaining a C-Corp?

- Spin-off the other program(s) at the time of the sale
 - Likely significant tax cost
- Spin-off the other program(s) at an early stage
 - Lower value results in limited, if any, tax cost
 - Independent companies
 - Required to finance each separately



The LLC Holding Company Structure

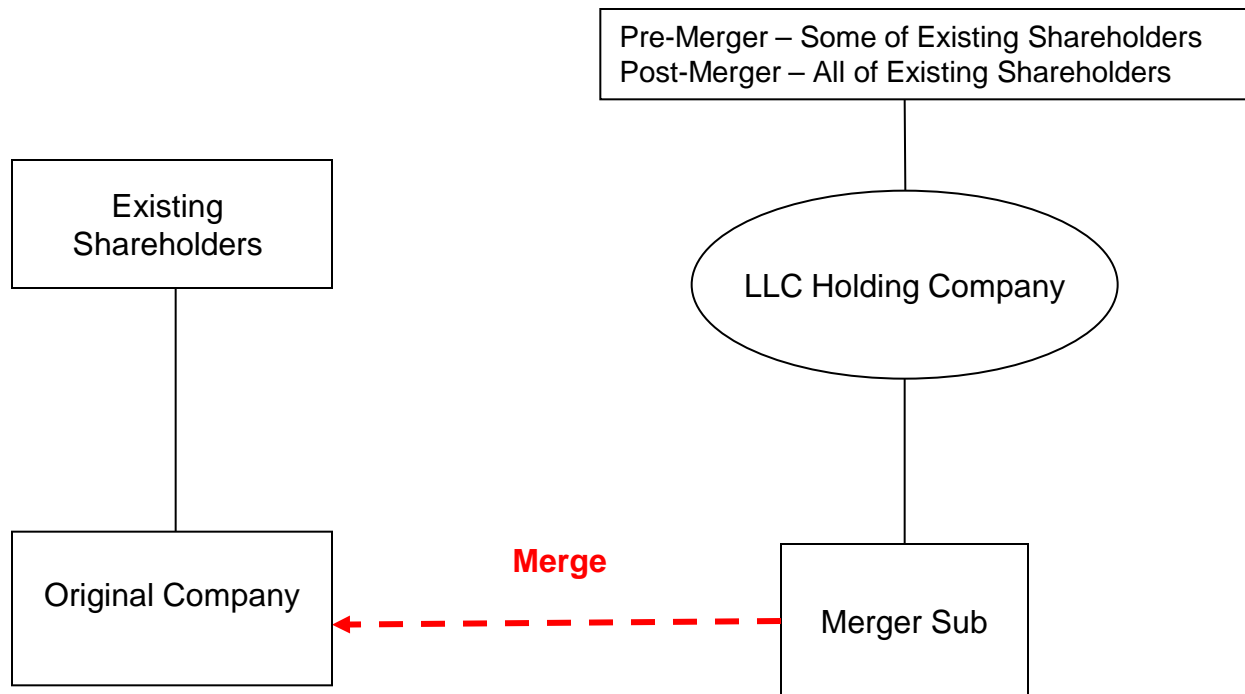
- Investors invest in LLC and programs are held in subsidiaries (typically c-corps; possibly LLCs)





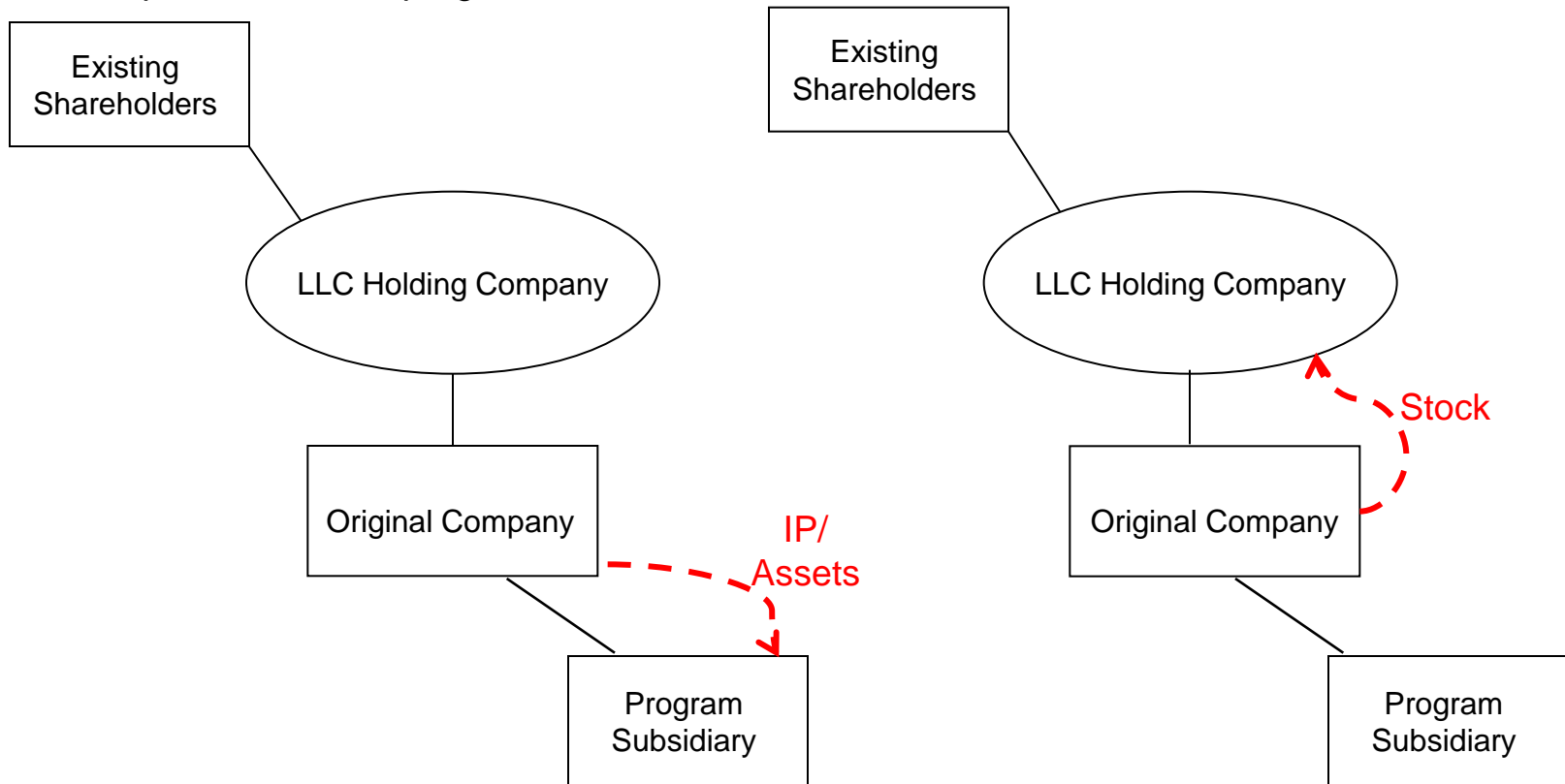
Establishing the LLC Holding Co. Structure

Original Company Merges with Merger Sub (tax free). Some or all of the existing shareholders set up LLC Holding Company with a wholly-owned subsidiary corporation. The subsidiary then merges with and into Original Company with all of the shareholders of the Original Company receiving corresponding interests in LLC Holding Company. Merger is tax free.



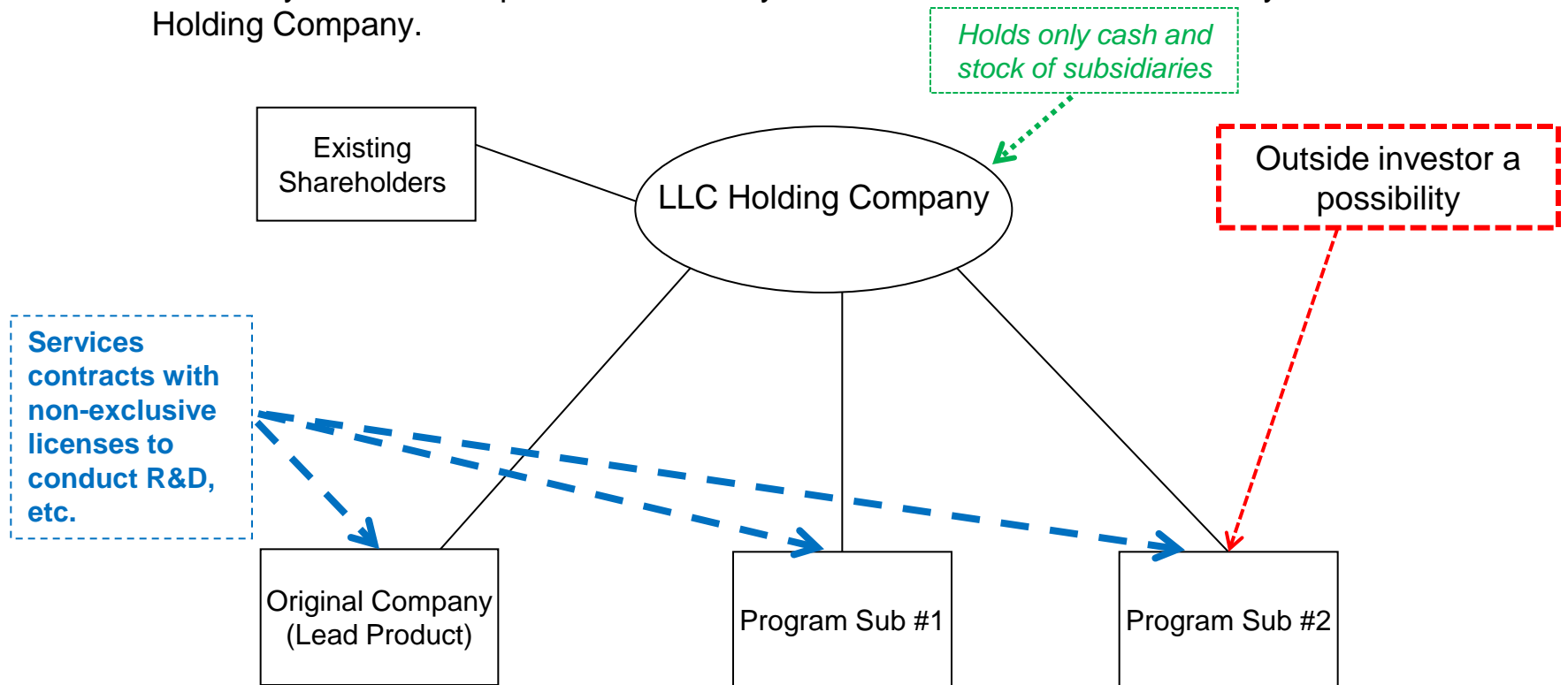
WH Establishing the LLC Holding Co. Structure

Creating the Program Subsidiaries. If a new program will be pursued out of IP located in the Original Company, the Original Company contributes IP to a newly formed C corporation subsidiary and distributes stock of subsidiary out to LLC Holding Company. Process is repeated for each program. This is a taxable transaction.



WH Establishing the LLC Holding Co. Structure

Operating and Scaling Up. The R&D employees, administrative employees and lease remain at Original Company, which provides R&D services, administrative services and sub-leases space to each program subsidiary under intercompany services agreements. If a new program will be pursued out of IP located in an existing C corporation, that C corporation contributes IP to a newly formed C corporation subsidiary and distributes stock of subsidiary out to LLC Holding Company.



Tax Benefits of LLC Holding Company Structure

- LLC holding company is a tax “pass through” vehicle
- If program sale and distribution of net proceeds is effected by sale of stock of subsidiary, just one level of tax
 - Taxable gain is passed through to investors in LLC
 - Distribution of cash proceeds to LLC investors is tax free
- Can provide management equity at LLC level through profits interest
 - No cash payment required – zero cost equity
 - Capital gain rather than ordinary income



Other Benefits of LLC Holding Company Structure

- Facilitates “Pure Play” equity investment opportunities in individual programs (at program sub) as well as all programs (at LLC)
- Enhances preparedness for exit transactions, including management continuity after exits
- Provides convenient collection vehicle for contingent payments
- Can be implemented incrementally and is scalable



Drawbacks of LLC Holding Company Structure

- More complicated capital structure
 - Employees and some investors are not familiar with LLCs
- Transfer of IP from Original Company into program subsidiaries is a taxable event from original company
 - Could result in current tax due by existing company and shareholders
- Expensive to establish and administer
 - Create and operate multiple entities instead of a single entity
 - Need to track and allocate management time and other costs



Drawbacks of LLC Holding Company Structure

- Expensive to establish and administer, cont.
 - No consolidated tax returns
 - Undesirable if some subsidiaries generate income and others generate losses
 - Complex tracking of tax capital accounts
 - Corporate filings and sets of books and records for multiple entities
 - More expensive financing rounds because all economic and management terms must be precisely set forth; no corporate law to backstop
 - Need for Intercompany agreements



Drawbacks of LLC Holding Company Structure

- Foreign investors and VC funds with institutional LPs may be reluctant to invest in LLCs
 - C corporation subsidiaries avoid UBTI and ECI issues
- Tax imposed on inter-subsidiary movement of cash
- License deals would be at subsidiary level
 - Double tax problem persists
- IP may need to be divided into fields in licenses to subsidiaries
 - May be tricky to draw lines between fields



Timing Considerations

- Waiting until second program has matured means the tax cost to implement structure may be too high
- Establishing Holdco structure early in company life means a lower tax cost but may be offset by the extra cost of operating within the structure over time
 - Uncertainty as to likelihood of multiple exits



Summary

- Is it worth it?
- Do you plan to develop multiple programs, monetize these programs creating multiple exit events and distribute the proceeds to the shareholders upon each exit event?



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