FINANCING

TAX LAWS WON'T END R&D LIMITED PARTNERSHIPS

KEY BISCAYNE, Fla.—Reports of the death of R&D limited partnerships may have been somewhat exaggerated.

Despite the new U.S. tax laws—which mandate that R&D deductions can no longer be used to offset salary income—attendees at the recent Industrial Biotechnology Association (Washington, D.C) meeting here agreed that R&D limited partnerships (RDLPs) remain an important option in the funding of biotech research and development. Future deals will just have to be structured to give investors larger returns to offset the loss of tax advantages.

"RDLPs are still a viable financing mechanism," reports Hollings Renton, chief financial officer of Cetus Corp. (Emeryville, CA). "Due to tax law changes, however, I think it's fair to say that the relative costs have gone up compared to the other vehicles." On the plus side, he points out that the rate of return needed to make RDLPs attractive has come down from the era when interest rates hovered at 12 percent or more.

Renton's optimism stands out particularly because Cetus has decided to *discontinue* selling shares in its Cetus Healthcare Limited Partnership II (CHLP II). Scheduled to raise $50–100 million, this RDLP netted $62 million as of its first closing at the end of December. According to Renton, two factors combined to make it difficult for Cetus to sell this public partnership: the fact that it was competing with equity during a bull market, and the negative publicity concerning the results of clinical trials with interleukin-2, which is viewed as Cetus' flagship product. "Given the current market," he explains "it would have taken a great effort on management's part to get all the way to $100 million." And besides, Renton stresses, Cetus recently secured a five-year, $5-million loan at six percent interest from Holland's MIP Equity Fund (The Hague), and MIP has the rights to buy another $5-million worth of Cetus stock at $30 a share. Add to this "substantial government support put in place since the offering closed," and Cetus did not feel compelled to continue the RDLP.

CHLP II funds European development of a market basket of its recombinant anti-cancer products: interleukin-2, tumor necrosis factor, colony stimulating factor I, and breast and ovarian cancer immunotoxins. If the partnership had raised over $75 million, then the firm's antibody against gram-negative infections would have been included as well.

Under pressure to make partnerships pay off, companies are facing crucial choices as to *which* products go into the RDLP. Shirley Clayton, treasurer at Genentech (South San Francisco, CA), notes that new RDLPs will have to be structured to give investors more near-term cash flow. She stresses, however, that Genentech's partnerships were never sold strictly as tax deals.

In fact, Genentech's much-publicized $400-million buyout of its first two partnerships could play a catalytic role in stimulating further RDLPs. Companies were encouraged by the 12-point rise in Genentech stock following the announcement; investors were pleased with the rate of return on their initial $90-million investment.

Fred Middleton, a managing partner in Midvest Ventures (Palo Alto, CA) specializing in bio- and medical technology, is also bullish on RDLPs. As vice president of finance for Genentech from 1978–84, Middleton structured Genentech's first two RDLPs. He believes that, in light of the new tax laws, equity kickers attached to RDLPs will become even more important—this means companies with attractive futures will have much easier times selling RDLPs. Middleton also foresees large RDLPs being favored over small ones. After all, he reasons, the small ones take as much time to put together as the large but do not raise as much money.

Amgen (Thousand Oaks, CA) recently announced an RDLP, targeted at $75 million, to fund development of granulocyte colony stimulating factor and growth factors. In addition, the firm plans to raise a similar amount by selling 2 million shares of stock to the public. Philip Whitcome, Amgen's director of strategic planning, says the company has considered RDLPs a number of times before. In one instance it opted for a development deal with Johnson & Johnson (New Brunswick, NJ); once it sold equity instead; and once it did not end up raising money.

"Accounting games" are another factor working in favor of RDLPs, says Steven Burrill, chairman of Arthur Young's national high technology group (San Francisco, CA). If a company raises $100 million in equity and then spends it on research, he explains, this activity would be viewed as a $100-million loss. But if the firm raises the money through an RDLP, then the revenues from the partnership would offset the expense. Concludes Burrill: "I believe the RDLPs will be with us for a long period of time."

—Arthur Klausner

DELIBERATE RELEASE

CALIFORNIA FIRST TO FRAME BIOTECH STATUTES

WASHINGTON, D.C.—Two very similar, precedent-setting experiments to field-test genetically engineered organisms are again close to receiving final approval. The two proposals, which have put the federal biotechnology regulatory system to task, also are the first to test a state-level system for regulating the new technology. Early this year, California became the first state to organize and consolidate all the biotechnology regulations fitting under its existing laws. By late February it was not clear whether opponents of the planned experiments would abide by the new system or, instead, again try to block the releases.

The two proposals, one devised by Steven Lindow and his colleagues at the University of California (Berkeley) and the other by scientists at nearby Advanced Genetic Sciences (AGS, Oakland, CA), involve field-testing *Pseudomonas syringae* bacterial strains from which a single gene has been deleted using recombinant DNA techniques. The two experiments seek to determine whether such strains, modified so they will no longer support ice crystal formation, will prevent frost damage to potato and strawberry plants.

Although several federal- and state-appointed panels have rigorously analyzed the environmental safety of the two small-scale field-tests, approval has been held up pending re-examination of any potential adverse