

SURG II INC  
Form DEF 14A  
January 07, 2003

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )

Filed by the Registrant  x  
Filed by a Party other than the Registrant  o

Check the appropriate box:

- o Preliminary Proxy Statement
- o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- x Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to §240.14a-11(c) or §240.14a-12

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SURG II, INC.  
(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

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1) Amount Previously Paid:

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2) Form, Schedule or Registration Statement No.:

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3) Filing Party:

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4) Date Filed:

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**SURG II, INC.**

**800 Nicollet Mall, Suite 2690  
Minneapolis, Minnesota 55402**

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**NOTICE OF SPECIAL MEETING OF SHAREHOLDERS  
To Be Held On  
February 12, 2003**

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Notice is hereby furnished to the shareholders of Surg II, Inc., a Minnesota corporation ( Surg ), of a special meeting of shareholders (the Meeting ), to be held at 10:00 a.m. on February 12, 2003, at the Hyatt Regency Hotel, 1300 Nicollet Mall, Minneapolis, Minnesota, for the following purposes:

To vote on a proposal to amend Surg s Articles of Incorporation to increase its authorized \$0.01 par value capital stock from 5,000,000 shares to 50,000,000 shares.

To vote on a proposal to amend Surg s Articles of Incorporation to change its name from Surg II, Inc. to Chiral Quest, Inc.

To transact such other business incidental to the Meeting.

Only shareholders of record as of the close of business on December 31, 2002, or their legal representatives, are entitled to notice and to vote at the Meeting or any adjournment thereof. Each shareholder is entitled to one vote per share on all matters to be voted on at the Meeting.

A Proxy and Proxy Statement are enclosed herewith. You are requested to complete and sign the Proxy, which is being solicited by the Board of Directors and management of Surg, and to return it in the envelope provided.

By Order of the Board of Directors

President and Chief Executive Officer

January 9, 2003

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Brian D. Niebur

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Vincent M. Aita

Stephen C. Rocamboli

Alan D. Roth

David M. Tanen

Michael Weiser

Xumu Zhang

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**PROXY STATEMENT**

**OF**

**SURG II, INC.**

**800 Nicollet Mall, Suite 2690  
Minneapolis, Minnesota 55402**

**For a Special Meeting of Shareholders**

**To Be Held On February 12, 2003**

This Proxy Statement is furnished to the shareholders of Surg II, Inc. (referred to as Surg ), in connection with the solicitation by the Board of Directors of Surg of proxies to be voted at the special meeting of Surg shareholders or any adjournment thereof (the Meeting ), to be held at 10:00 a.m. on February 12, 2003, at the Hyatt Regency Hotel, 1300 Nicollet Mall, Minneapolis, Minnesota. This Proxy Statement and the accompanying proxy were first mailed on approximately January 10, 2003, to the shareholders of record of Surg as of the close of business on December 31, 2002.

The accompanying Proxy authorizes the appointees named in the Proxy, acting at the request of the management of Surg, to vote the shares indicated in the Proxy as follows:

1. For or against approving an amendment to the Surg Articles of Incorporation increasing the number of shares of \$0.01 par value capital stock which Surg may issue from 5,000,000 to 50,000,000.
2. For or against approving an amendment to the Surg Articles of Incorporation changing the name of Surg to Chiral Quest, Inc.
3. In their discretion, to vote on matters which are incidental to the Meeting.

**The solicitation of proxies from the shareholders is being made by the Board of Directors and management of Surg who will not be specially compensated for such solicitation.**

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**SUMMARY**

**The Proposals**

The management of Surg II, Inc. (Surg or we) has called the Meeting, and is asking Surg's shareholders to approve two amendments to Surg's Articles of Incorporation. The amendments are being proposed to facilitate the acquisition of Chiral Quest, LLC, a Pennsylvania limited liability company (Chiral Quest) by the merger (the Merger) of Chiral Quest into a wholly owned subsidiary of Surg called CQ Acquisition, Inc. The business of Chiral Quest and the terms of the Merger are discussed elsewhere in this Proxy Statement. Following the proposed Merger, Surg's entire business operations will be devoted to Chiral Quest's current business. Accordingly, unless the context indicates otherwise, when we discuss or refer to business or financial information in this Proxy Statement that relates to dates following completion of the proposed Merger, we are referring to Chiral Quest's business and financial information.

The first amendment to be considered at the meeting would increase the number of authorized shares of capital stock Surg may issue. Currently, Surg may issue only up to 5,000,000 shares. There are currently 4,348,720 shares of Surg common stock outstanding. The Merger will require Surg to issue to the members of Chiral Quest approximately 8,652,300 shares of Surg common stock. Accordingly, Surg is requesting its shareholders to approve an increase in the number of shares which Surg may issue to 50,000,000 shares.

If a sufficient number of Surg shareholders do not approve the amendment to increase the number of authorized shares, the Merger cannot occur. Accordingly, voting on that proposal has the practical effect of voting on the Merger itself.

The second amendment would change the name of Surg to Chiral Quest, Inc. The change in name will more closely reflect the business Surg will be engaged in should the Merger occur. If the Merger is not completed, Surg will not effect the change in its name.

Chiral Quest was organized in July 2000 and in October 2000 commenced to engage in the research, development and production of chemical compounds called ligands, which act as catalysts for chemicals used in the production of pharmaceuticals and fine chemicals. Chiral Quest currently markets limited quantities of ligands and licenses the use of these ligands to pharmaceutical, biotechnology and fine chemical companies for research and development purposes. The technology for Chiral Quest's research, development and production activities was developed by Dr. Xumu Zhang, and is licensed from the Pennsylvania State Research Foundation (Penn State Foundation), the technology development arm of Pennsylvania State University (Penn State). Dr. Zhang is an associate professor at Penn State, and is a significant owner of and consultant to Chiral Quest. Chiral Quest is in the early stages of its development and has not yet generated significant revenues.

**Voting Information**

***Who is entitled to vote?***

The holders of common stock of Surg who are shareholders of record on December 31, 2002, may vote at the Meeting. As of December 31, 2002, there were 4,348,720 shares of Surg's common stock outstanding.

***What are you voting on?***

At the Meeting, the following matters will be voted on:

An amendment to the Articles of Incorporation of Surg to increase its authorized \$0.01 par value per share capital stock from 5,000,000 shares to 50,000,000 shares.

An amendment to the Articles of Incorporation of Surg to change its name from Surg II, Inc. to Chiral Quest, Inc.

Other matters incidental to conducting the Meeting.



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***What is the purpose of the proposed amendments?***

We have entered into a Merger Agreement (the Merger Agreement ) with Chiral Quest, whereby Chiral Quest will be merged with and into Surg s wholly owned subsidiary, CQ Acquisition, Inc. A copy of the Merger Agreement without schedules is included in this Proxy Statement as Exhibit A. In the Merger, the members/owners of Chiral Quest are to receive approximately 8,652,300 shares of the common stock of Surg. Since we currently do not have authority to issue that many shares, we need to increase the number of shares authorized for issuance in Surg s Articles of Incorporation in order to complete the transaction. Changing Surg s name to Chiral Quest, Inc. also requires an amendment to the Articles of Incorporation, but is not necessary to complete the Merger.

***Will the Merger proceed if the proposal to increase Surg s authorized shares is defeated?***

No. A vote against the proposed amendment to Surg s Articles of Incorporation increasing the number of shares we may issue is essentially a vote against the Merger. Currently, we do not have authority to issue enough shares to meet the requirements of the Merger. Without the increase, the Merger will not be completed.

***Will the proposal to change Surg s name be presented to the shareholders if the proposal to increase Surg s authorized shares is defeated?***

No. If the proposal to amend Surg s Article of Incorporation to increase its authorized shares is not approved, the meeting will be adjourned and the proposal to change Surg s name to Chiral Quest, Inc. will not be presented to the shareholders for a vote.

***Will defeat of the proposal to change Surg s name prevent the Merger?***

No. The Merger Agreement contemplates that we will propose the name change to our shareholders at the Meeting, but the Merger is not dependent upon the name change.

***Will the Merger with Chiral Quest proceed if the proposal to increase Surg s authorized shares is approved?***

Very likely. The amendment to increase the authorized capital stock of Surg is a condition to completing the Merger. The Merger Agreement, however, has conditions other than approval of Surg s authorized shares which, if not satisfied, may allow either Surg or Chiral Quest to terminate the Merger Agreement. These include conditions requiring that:

the warranties and representations of the parties made in the Merger Agreement are true as of the time of the Merger;

the Merger be accomplished by February 28, 2003;

the Merger qualify as a tax free reorganization; and

Surg have at least \$3,000,000 in cash and only limited liabilities at the time of the Merger.

***What will happen if both amendments to the Articles of Incorporation are approved, but the Merger is not completed?***

If that were to occur, Surg would effect the amendment to increase the number of shares of its authorized capital stock, but would not change its name.

***Do you have statutory rights of appraisal if you oppose the Merger?***

No. Under Minnesota law, a shareholder asked to approve a merger of that shareholder s corporation has the right to dissent from the transaction and receive the fair value of his or her shares in cash. You, however, are not being asked to vote on the Merger; you are only being asked to vote on amendments to Surg s Articles

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of Incorporation. The Merger is between Surg's subsidiary, CQ Acquisition, Inc. and Chiral Quest. The only statutory right to receive the fair value of shares under Minnesota law belongs to Surg as the shareholder of CQ Acquisition, Inc.

### ***How does the Board recommend you vote on the proposals?***

The Board recommends you vote your shares **FOR** both proposed amendments to Surg's Articles of Incorporation.

### ***Who will be soliciting your vote?***

The Board of Directors is soliciting your vote by mail through this Proxy Statement. Your vote may also be solicited in person or by telephone by officers of Surg. Brokers, nominees, fiduciaries and other custodians will be requested to forward soliciting materials to beneficial owners of Surg's common stock, and will be reimbursed for their expenses in connection with that activity. The cost of all of this solicitation is being paid for by Surg.

### ***How can you vote?***

If you hold your shares as a shareholder of record, you can vote in person at the Meeting or you can vote by completing and mailing the form of proxy provided to you. You are a shareholder of record if you hold your shares directly in your own name. If you hold your shares indirectly in the name of a bank, broker or other nominee, you are a street name shareholder. If you are a street name shareholder, you will receive instructions from your bank, broker or other nominee describing how to vote your shares.

### ***How do you vote by mail?***

You can vote by mail by following the instructions on the accompanying form of proxy, signing the proxy and mailing it to the address noted on the form of proxy or by using the accompanying envelope provided for that purpose. The individuals named as proxies on the form of proxy will vote your shares in accordance with your instructions. If you sign and submit your proxy without giving instructions, the proxies named on the form of proxy will vote your shares as recommended by the Board of Directors.

### ***How can you revoke your proxy after mailing it?***

If you are a shareholder of record, you can revoke your proxy by:

Submitting a new form of proxy with a later date on it;

Giving written notice before the Meeting to Surg's Secretary, at 800 Nicollet Mall, Suite 2690, Minneapolis, Minnesota 55402, stating that you are revoking your proxy; or

Attending the Meeting and voting your shares in person.

Merely attending the Meeting without voting will not revoke your proxy.

If you are a street name shareholder, you may revoke your proxy only as instructed by the bank, broker or other nominee holding your shares.

### ***How do you sign the proxy?***

Sign your name exactly as it appears on the form of proxy. If you are signing in a representative capacity (for example, as a guardian, trustee, executor, administrator, attorney-in-fact or the officer or agent of a company), include your name and title or capacity. If the shares are held in custody (for example, under the Uniform Transfer to Minors Act), the custodian should sign, not the minor or other beneficiary. If the shares are held in joint ownership, both owners must sign.

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### ***What does it mean if you receive more than one proxy or voting instruction form?***

It means your shares are registered differently or are in more than one account. Please complete, sign and return all proxy forms you receive to ensure all your shares are voted.

### ***What constitutes a quorum?***

A quorum of shareholders is necessary to hold a valid meeting of our shareholders. A majority of the outstanding shares, present in person or represented by proxy, constitutes a quorum for the Meeting. Shareholders who send in their proxy but abstain from voting and broker non-votes are counted as present for establishing a quorum.

### ***How many votes are needed for approval of each proposal?***

The two amendments to Surg's Articles of Incorporation each require the affirmative vote of at least a majority of the shares present at the Meeting. Abstentions and broker non-votes are counted as shares present at the Meeting. Accordingly, an abstention from voting on any proposal or a broker non-vote is the same as a vote against that proposal.

### ***What is a broker non-vote?***

A broker non-vote occurs when a broker submits a proxy form that does not indicate a vote for some of the proposals because the broker did not receive instructions from the beneficial owner on how to vote on those proposals and does not have discretionary authority to vote in the absence of instructions.

### ***How can you attend the Meeting?***

If you are a shareholder of record on December 31, 2002, you can attend the Meeting by presenting acceptable identification at the Meeting. If you are a street name shareholder you may attend the Meeting by presenting acceptable identification along with evidence of your beneficial ownership of Surg's common stock. As a street name shareholder, however, you will not be able to vote your shares unless the organizations through which you hold your shares provide proxies giving you authority to vote the shares held for you. This may require more than one proxy, as the record owner of your shares is usually not the organization providing you the account in which your shares are held.

## **Risk Factors**

In deciding to approve proposals 1 and 2, you are urged to consider the following risk factors which will apply to Surg should the Merger be completed:

### **Risks Relating to the Merger**

#### ***Surg may not realize the anticipated benefits of the Merger.***

Although Surg's Board of Directors believes that the Merger is in the best interests of Surg and its shareholders, Chiral Quest is still an early stage company without any significant operating history on which to evaluate its business and prospects. Accordingly, there can be no assurance that, following the Merger, Surg and its new management will be successful in implementing Chiral Quest's business plan.

#### ***The Merger will significantly dilute your percentage ownership in Surg.***

If the Merger is completed, Surg will issue to the members of Chiral Quest a number of shares of Surg common stock that is approximately twice the number of shares held, in the aggregate, by the current shareholders of Surg. In addition, certain key employees of Chiral Quest will have options to acquire approximately an additional 910,400 shares of Surg's common stock. Surg has also agreed to issue a warrant to purchase up to 550,000 shares of Surg common stock to an entity, the principal owner of which introduced



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Surg to the opportunity to acquire Chiral Quest (See THE MERGER Other Agreements ). Accordingly, the Merger will result in substantial dilution to your current ownership and voting interests in Surg.

### ***The Merger will result in a significant dilution in the book value of your shares.***

As of September 30, 2002, Surg had a net tangible book value of \$3,171,608 or approximately \$0.73 per share. As of that date, Chiral Quest's liabilities exceeded its tangible assets by \$430,344. Since September 30, 2002, the deficit book value of Chiral Quest has increased. Had the Merger occurred on September 30, 2002, it would have resulted in a dilution, on a per share net tangible book value basis, to current Surg shareholders of approximately \$0.52 per share.

### ***Following the Merger, a small group of persons will be able to exert significant control over Surg.***

Following the Merger, Chiral Quest's current officers and directors will beneficially own or control approximately 29% of Surg's common stock. Individually and in the aggregate, these persons will have significant influence over the management of Surg's business, the election of directors and all matters requiring shareholder approval. In particular, this concentration of ownership may have the effect of facilitating, delaying, deferring or preventing a potential acquisition of Surg and may adversely affect the market price of Surg's common stock. Additionally, four of the persons proposed to be appointed to Surg's Board of Directors following the Merger are employees of Paramount Capital, Inc., or one of its affiliates. Dr. Lindsay A. Rosenwald is the chairman and sole owner of Paramount Capital, Inc., and such affiliates. Following the Merger, Dr. Rosenwald will beneficially own 4.9% of Surg's outstanding common stock, and several trusts for the benefit of Dr. Rosenwald and his family will beneficially own 14.7% of Surg's outstanding common stock. Dr. Rosenwald does not have the legal authority to exercise voting power or investment discretion over the shares held by those trusts; however, as a result of the foregoing, Dr. Rosenwald will have the ability to exert significant influence over Surg (See CERTAIN TRANSACTIONS AND RELATIONSHIPS Interests of Proposed Directors in Chiral Quest and Paramount Capital, Inc. ).

## **Risks Relating to Chiral Quest's Operations**

### ***Chiral Quest has no meaningful operating history on which to evaluate its business or prospects.***

Chiral Quest was formed in July 2000 and commenced operations in October 2000. Chiral Quest has only a limited operating history on which you can base an evaluation of its business and prospects. Accordingly, its business prospects must be considered in the light of the risks, uncertainties, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies in new and rapidly evolving markets, such as the fine chemical, pharmaceutical and biotechnology markets.

### ***Chiral Quest's management anticipates incurring losses for the foreseeable future.***

For the nine months ended September 30, 2002, Chiral Quest had a net loss of \$280,552, and since its inception in October 2000 through September 30, 2002, Chiral Quest has incurred an aggregate net loss of \$1,135,379. As of September 30, 2002, Chiral Quest had total assets of \$456,921. Its management expects operating losses to continue for the foreseeable future and there can be no assurance that it will ever be able to operate profitably.

### ***Following the Merger, Chiral Quest will require additional financing in order to complete the development of its products and services, which may not be available on acceptable terms, or even at all.***

Chiral Quest anticipates that the capital provided by Surg upon the Merger will be adequate to fund its operations at least through 2003. However, changes may occur that would consume available capital resources before that time. Chiral Quest's combined capital requirements will depend on numerous factors, including competing technological and market developments; changes in its existing collaborative relationships; the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights and the outcome of any potentially related litigation or other dispute; the purchase of additional capital equipment;



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acquisition of technologies; and the development and regulatory approval progress of its customers' product candidates into which Chiral Quest's technology will be incorporated.

Additional capital which may be needed by Chiral Quest in the future may not be available on reasonable terms, or at all. If adequate financing is not available, Chiral Quest may be required to terminate or significantly curtail its operations, or enter into arrangements with collaborative partners or others that may require Chiral Quest to relinquish rights to certain of its technologies, or potential markets that it would not otherwise relinquish.

***Potential fluctuations in results of operations; difficulty in predicting results of operations.***

As it develops its business, Chiral Quest expects its revenues and operating results to vary significantly from quarter-to-quarter. As a result, quarter-to-quarter comparisons of Chiral Quest's revenues and operating results may not be meaningful. In addition, due to the fact that it has little or no significant operating history with its new technology, Chiral Quest cannot predict its future revenues or results of operations accurately. Chiral Quest's current and future expense levels are based largely on its planned expenditures and estimates of future revenues. Accordingly, it may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall, and any significant shortfall in revenues relative to its planned expenditures could have an immediate adverse effect on Chiral Quest's business and results of operations.

***Chiral Quest may be unable to develop successful customer relationships.***

Chiral Quest intends to establish relationships with various types of customers and partners, such as pharmaceutical and fine chemical manufacturers. Each of these relationships will involve negotiation of terms and fees. Chiral Quest cannot be certain that it will be able to negotiate profitable relationships or that it can successfully fulfill its obligations under development agreements that will allow it to continue these relationships.

***Chiral Quest's future success is highly dependent on the continued availability of Dr. Xumu Zhang and other key employees and consultants.***

In connection with the continued development of Chiral Quest's products and services, it is substantially dependent upon on the continued service of its existing research personnel, including in particular, Dr. Xumu Zhang. Dr. Zhang, an associate professor at Penn State, acts as Chiral Quest's chief technology officer and provides essential services to Chiral Quest pursuant to a consulting agreement with Chiral Quest (See CERTAIN TRANSACTIONS AND RELATIONSHIPS - Dr. Zhang Consulting Agreement). Dr. Zhang may terminate the consulting agreement upon 60 days' notice. Chiral Quest does not currently maintain any key-man life insurance with respect to Dr. Zhang. Chiral Quest also employs other research scientists who are critical to its success. Although Chiral Quest's employees and consultants have entered into confidentiality agreements, most have not entered into noncompete agreements with Chiral Quest. The loss of one or more of Chiral Quest's research personnel, especially Dr. Zhang, could prevent or delay the ongoing development of its products and services, which would materially and adversely affect its business.

***Chiral Quest's license agreement with Penn State Foundation may be terminated if Chiral Quest does not achieve certain milestones.***

Chiral Quest's business is based on technically complex products and services (See INFORMATION REGARDING CHIRAL QUEST). Chiral Quest does not directly own this technology, but rather has the exclusive, worldwide right to use it pursuant to a license agreement with the Penn State Foundation. Currently, Chiral Quest's commercial success depends entirely on this licensed technology. Pursuant to the license agreement, Chiral Quest is required to use its best efforts to achieve gross revenue (as defined in the license agreement) of at least \$250,000 in 2004, at least \$350,000 in 2005 and at least \$500,000 in 2006. In the event Chiral Quest fails to achieve these milestones, or otherwise materially breaches the license agreement, Penn State Foundation may have the right, but not the obligation, to terminate the license. Unless Chiral

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Quest subsequently develops its own technology independent of the Penn State Foundation, termination of this license would preclude Chiral Quest from implementing its business plan.

***Chiral Quest relies heavily on its relationship with Penn State.***

In addition to the license agreement with the Penn State Foundation, Chiral Quest relies heavily on its relationship with Penn State for its research and development activities and as Chiral Quest's only current supplier of its ligands. Chiral Quest's current agreement with Penn State obligates Chiral Quest to fund four Penn State post-doctorate fellows to produce research quantities of chiral ligands to Chiral Quest. This arrangement expires on October 15, 2003. Chiral Quest has no agreement with Penn State to produce its ligands in commercial quantities and Penn State does not currently have such capabilities. Should the post-doctoral fellows at Penn State fail to produce the chiral ligands in sufficient quantities or cease to produce the ligands altogether, it could materially and adversely affect Chiral Quest's business operations. Even if Chiral Quest could establish additional or replacement supplies of its ligands in a timely fashion, it may not be able to do so on commercially reasonable terms. In order to obtain research quantities of ligands after October 15, 2003, Chiral Quest will have to either enter into a new agreement with Penn State or find another source. There is no guarantee that Chiral Quest will be able to enter into such new agreement or find an alternative source for its ligands on commercially reasonable terms. Any material interruption in the supply of the ligands will have a material adverse effect on Chiral Quest's business.

***Chiral Quest may rely heavily on third parties to formulate and manufacture its products.***

Chiral Quest currently lacks the resources to formulate or manufacture its own products on a commercial scale. Chiral Quest's researchers, who are employed by Penn State, currently only have the ability to develop Chiral Quest's ligands in research quantities. If any of Chiral Quest's customers require its ligands in commercial quantities in the near term, Chiral Quest may have to rely on one or more third-party contractors to manufacture the ligands to satisfy the needs of such customers. Reliance on one or more third-party manufacturers exposes Chiral Quest to certain risks, including the following:

Chiral Quest may be unable to replace manufacturers on commercially reasonable terms or at all because the number of potential manufacturers is limited, and the United States Food and Drug Administration (FDA), or such similar regulatory authorities, may have to approve any replacement contractor;

Third-party manufacturers might be unable to formulate and manufacture Chiral Quest's ligands in the volume and of the quality required to meet customers' clinical and commercial needs;

Chiral Quest's existing and future contract manufacturers may not perform as agreed or may not remain in the contract manufacturing business for the time required to supply Chiral Quest's customers to complete their clinical trials or to successfully produce, store and distribute Chiral Quest products;

Drug manufacturers are subject to ongoing periodic unannounced inspections by the FDA and corresponding state agencies to ensure strict compliance with good manufacturing practice and other government regulations and corresponding foreign standards, which Chiral Quest would be unable to control; and

If any third-party manufacturer makes improvements in the manufacturing process for Chiral Quest's products, Chiral Quest may not own, or may have to share, the intellectual property rights to the innovation.

Each of these risks could delay the clinical trials conducted by Chiral Quest's customers, approvals required by regulatory authorities, and the commercialization of some of Chiral Quest's customers' product candidates. These risks could also result in higher costs to the customer or could deprive Chiral Quest of potential product revenues.

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***Chiral Quest needs to create and grow its scientific, sales and support operations.***

Chiral Quest will need to create and substantially grow its direct and indirect sales operations, both domestically and internationally, in order to create and increase market awareness and sales of its products and services. The sale of Chiral Quest's products and services will require the engagement of sophisticated and highly knowledgeable sales personnel. Similarly, the anticipated complexity of Chiral Quest's products and services and the difficulty of customizing them will require Chiral Quest to hire research and development personnel, and customer service and support personnel, highly trained in chiral chemistry and chemical engineering. Competition among Chiral Quest and others to retain qualified sales personnel, chemists and chemical engineers is intense due to the limited number of available qualified candidates for such positions. Many of Chiral Quest's competitors are in a financial position to offer potential employees of Chiral Quest greater compensation and benefits than those which may be offered by Chiral Quest. Failure to recruit and retain such persons will have a material adverse effect on Chiral Quest's business operations.

***Chiral Quest's future success is dependent on the management of its potential growth.***

The future success of Chiral Quest depends upon its ability to grow its business. Such growth, if it occurs, will require Chiral Quest to establish management and operating systems, hire additional support technical and sales personnel, and establish and maintain its own independent office, research and production facilities. Failure to manage that growth efficiently could have a material adverse affect on Chiral Quest.

***Chiral Quest currently has no capabilities and no experience in manufacturing its products on a commercial scale.***

Chiral Quest does not currently have the experience or ability to directly manufacture or market any chemical or pharmaceutical products in commercial quantities that may be developed under its collaborative arrangements. Rather, Chiral Quest currently intends to rely on third parties to manufacture its ligands, although it may determine in the future to develop its own manufacturing capabilities. In addition, Chiral Quest has not yet developed a cost effective and efficient commercial manufacturing process for its ligands, and may never be able to do so. To the extent Chiral Quest is unable to produce, directly or indirectly, its ligands in quantities required for commercial use, it will not realize any benefits from its technology. Further, in the event Chiral Quest decides to establish a manufacturing facility in the future, Chiral Quest may require substantial additional funds, and will be required to hire and train a significant number of additional personnel, and, in certain circumstances, may need to comply with the extensive FDA good manufacturing practice regulations applicable to such a facility.

**Risks Relating to Chiral Quest's Industry**

***Chiral Quest faces intense competition.***

Chiral Quest competes directly with the in-house research departments of fine chemical, pharmaceutical and biotechnology companies, as well as contract research companies, and research and academic institutions. Many of its competitors have greater financial and other resources than it has. As new companies enter the market and as more advanced technologies become available, Chiral Quest expects to face increased competition. In the future, any one of its competitors may develop technological advances that render obsolete the products or services that Chiral Quest provides or may provide in the future. While Chiral Quest plans to develop new and better technologies, which will give it competitive advantages, its competitors plan to do the same. Chiral Quest may not be able to develop the technologies it needs to successfully compete in the future, and its competitors may be able to develop such technologies before it does. Consequently, Chiral Quest may not be able to successfully compete in the future.

***The fine chemical, pharmaceutical and biotechnology industries involve rapidly changing technologies.***

Rapid technological change and uncertainty due to new and emerging technologies characterize the drug and fine chemical development industries. Chiral Quest may not be able to develop, integrate and market, on a

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timely basis, the new and enhanced products and services necessary to keep pace with competitors. Failure to anticipate or to respond to changing technologies, or significant delays in product development or introduction, could cause its customers to delay or decide against purchases of Chiral Quest's products or services.

***Many of Chiral Quest's customers and potential customers are pharmaceutical and biotechnology companies, and Chiral Quest is subject to risks, uncertainties and trends that affect companies in these industries.***

For the foreseeable future, Chiral Quest will derive a substantial portion of its revenue from pharmaceutical and biotechnology companies. As a result, Chiral Quest will be subject to risks and uncertainties that affect the pharmaceutical and biotechnology industries and possible reduction and delays in research and development expenditures by companies in these industries. Chiral Quest's future revenues may also be adversely affected by mergers and consolidation in the pharmaceutical and biotechnology industries, which will reduce the number of potential customers.

In particular, pharmaceutical and biotechnology companies face significant regulation by governmental entities in the United States and other countries. The nature and the extent to which such regulation may apply to Chiral Quest's customers will vary depending on the nature of any such customers' products. Virtually all pharmaceutical products developed by Chiral Quest's customers will require regulatory approval by governmental agencies prior to commercialization. In particular, human pharmaceutical therapeutic products are subject to rigorous preclinical and clinical testing and other approval procedures by the U.S. Food and Drug Administration and by foreign regulatory authorities. Various federal and, in some cases, state statutes and regulations also govern or influence the manufacturing, safety, labeling, storage, record keeping and marketing of such pharmaceutical products. The process of obtaining these approvals and the subsequent compliance with appropriate federal and foreign statutes and regulations are time consuming, can cause significant delays in the commercialization of a drug, and often require the expenditure of substantial resources. To the extent Chiral Quest's customers experience significant delays in obtaining the necessary regulatory approvals to market their pharmaceutical products, or are unable to obtain such approvals at all, these customers will not purchase from Chiral Quest its proprietary ligands and other services used in the manufacture of the ultimate pharmaceutical product.

***Chiral Quest may be held liable for harm caused by drugs that its customers develop and test.***

Chiral Quest's ligands may be used by its customers to produce drugs that are used by humans. If any of the drugs cause injuries or illness to people, Chiral Quest may be required to incur substantial costs in defending against such claims and may be required to pay damages to those persons. Although it intends to obtain liability insurance and will use commercially reasonable efforts to obtain indemnification from its customers for their use of its products, such protections may not be sufficient to protect Chiral Quest from the cost of such claims. Damages awarded in a product liability action could be substantial and could have a material negative impact on Chiral Quest's financial condition.

***Chiral Quest may be held liable for contamination or other harm caused by hazardous materials that it uses.***

Some of Chiral Quest's research and development processes involve the use of hazardous materials and, therefore, it is subject to federal, state and local regulation governing the use, manufacture, handling, storage and disposal of hazardous materials. Chiral Quest cannot completely eliminate the risk of contamination or injury resulting from hazardous materials and it may incur liability as a result of any contamination or injury. Chiral Quest may also incur expenses relating to compliance with environmental laws. Such expenses or liability could have a significant negative impact on its financial condition.

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**Risks Relating to Chiral Quest's Technology**

***Chiral Quest may not be able to license technologies that it needs to conduct its business.***

In addition to the technologies that it develops, Chiral Quest also relies heavily on technologies that it licenses from other companies or institutions. Chiral Quest may not be able to license technologies that it needs in the future or it may be unable to license such technologies on a commercially reasonable basis. Although its license agreement with the Penn State Foundation provides that Chiral Quest is entitled to use any improvements subsequently made to the technologies it currently licenses, the Penn State Foundation's obligation to license, for no additional consideration, any new technologies subsequently discovered by Dr. Zhang and researchers at Penn State expired on November 8, 2002. If Chiral Quest is unable to license the technologies it needs in the future, or to license or otherwise acquire such technologies on commercially reasonable terms, Chiral Quest could experience increased costs and, therefore, reduced profits, or be unable to engage in certain activities that require those technologies. Accordingly, failure to license the technologies it needs in the future or failure to license or otherwise acquire such technologies on commercially reasonable terms could have a material adverse effect on Chiral Quest's business operations.

***Chiral Quest's success depends on its ability to protect its proprietary technology.***

Chiral Quest's rights to a substantial portion of its technology are as the exclusive licensee to several United States patents and a number of United States and foreign pending patent applications held by the Penn State Foundation including the ligands that comprise Chiral Quest's Toolbox. These patents and patent applications are based primarily upon the work of Dr. Zhang, Chiral Quest's chief technology officer, who is also an associate professor at Penn State. Chiral Quest's success will depend largely on its ability, and the ability of its licensors and licensees, to obtain patents for their technologies and products, if any, resulting from the application of such technologies, defend patents once obtained, and maintain trade secrets.

If Chiral Quest is unable to protect its intellectual property, or incurs significant expense in doing so, its business, operating results and financial condition may be materially adversely affected. Any steps Chiral Quest takes to protect its intellectual property may be inadequate, time consuming and expensive.

Chiral Quest's success and ability to compete are substantially dependent upon its internally developed products and services, which it protects and intends to protect through the use of United States and foreign patents, and to the extent such products and services are not patentable, Chiral Quest will rely on trade secret protection. As with other knowledge-based products, however, Chiral Quest's patent positions rest on complex factual and legal issues that are not entirely resolved and there can be no assurance that the patents utilized by Chiral Quest will adequately protect its proprietary products and services. Although Chiral Quest has taken steps to protect its unpatented trade secrets and know-how, in part through the control of access to such information and through the use of confidentiality agreements with its employees, consultants and certain of its contractors, customers and potential customers, there can be no assurance that these agreements will not be breached, that Chiral Quest would have adequate remedies for any breach, or that Chiral Quest's trade secrets will not otherwise become known or be independently developed or discovered by competitors. Despite Chiral Quest's efforts to protect its proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use its products or technology. Chiral Quest anticipates that policing unauthorized use of its products will be difficult, and it cannot be certain that the steps it intends to take to prevent misappropriation of its technology, particularly in foreign countries where the laws may not protect its proprietary rights as fully as in the United States, will be successful. Other businesses may also independently develop substantially equivalent information.

***Foreign laws may not afford Chiral Quest sufficient protection for its intellectual property and, in certain cases, Chiral Quest may not seek patent protection outside the United States.***

Chiral Quest believes that its success will depend, in part, upon its ability to obtain international protection for its intellectual property. Chiral Quest has existing foreign customers and believes it will have access to large markets overseas. However, the laws of some foreign countries may not be as comprehensive as

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those of the U.S. and may not be sufficient to protect Chiral Quest's proprietary rights abroad. In addition, in certain cases, Chiral Quest may decide not to pursue patent protection outside the United States, because of cost and confidentiality concerns. Accordingly, Chiral Quest's international competitors could obtain foreign patent protection for, and market overseas, technology for which Chiral Quest is seeking U.S. patent protection, though such competitors' patent protection generally requires such competitors to make their patent filings prior to information on Chiral Quest's relevant inventions becoming sufficiently available under local law as to block the availability of such competitors' patent protection.

***Chiral Quest's technology may infringe on the proprietary rights of others.***

Chiral Quest anticipates that other patents it licenses or may license in the future will be increasingly subject to infringement claims due to the rapid development of chiral chemistry and competitors in its industry. In fact, one potential competitor, Solvias, AG, based in Basel, Switzerland, has recently notified Chiral Quest of its claim that one of the patented ligands Chiral Quest licenses from the Penn State Foundation infringes on a patent that Solvias licenses from BASF Group, AG. See INFORMATION REGARDING CHIRAL QUEST Legal Proceedings. Some of Chiral Quest's other competitors or potential competitors may have filed or intend to file patent applications that may make claims that conflict with Chiral Quest's own patent claims. Chiral Quest cannot be certain that these competitors or other third parties will not assert infringement claims against Chiral Quest with respect to its products and technology. Any infringement claim, including Solvias' claim, regardless of its merit, could be time-consuming and expensive to defend. Such claims may also require Chiral Quest to enter into royalty or licensing agreements in order to continue using some of its technology. In the event Chiral Quest could not afford to defend itself against an infringement claim or is not able to enter into a license or royalty agreement on commercially favorable terms, or at all, it may be required to abandon the technology that is subject to such claims.

**Proposal No. 1**

**AMENDMENT TO ARTICLES OF INCORPORATION TO  
INCREASE AUTHORIZED SHARES**

**General**

The Board of Directors is proposing that the Articles of Incorporation of Surg be amended to increase the authorized \$0.01 per share par value capital stock of Surg from 5,000,000 shares to 50,000,000 shares.

**Specific Language of Amendment to Increase Capitalization**

If approved by the shareholders, the existing Article III of Surg's Articles of Incorporation would be amended in its entirety to read as follows:

**ARTICLE III.**

**AUTHORIZED SHARES**

The aggregate number of shares that this Corporation has authority to issue is fifty million shares having a par value of \$0.01 per share. Unless otherwise designated, all shares issued shall be designated as common shares. Each holder of common shares shall be entitled to one vote for each common share standing in his name on the books of the Corporation. The Board of Directors is authorized to adopt, by an affirmative vote of a majority of the directors present at a duly called meeting, a resolution or resolutions providing for the establishment of a class or series of authorized shares of the Corporation, setting forth the designation of and number of shares constituting the class or series, and fixing the relative rights and preferences of the class or series. The Board of Directors may grant preemptive rights with respect to some or all of the shares not designated common shares.

The amendment to Article III of the Articles of Incorporation involves only a change to the number of authorized shares from 5,000,000 shares to 50,000,000 shares. The Board of Directors will continue to be able

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to designate different classes or series of shares of Surg's capital stock, having rights and preferences superior to those held by common stockholders, without obtaining the approval of Surg's shareholders.

**Purpose and Effect of the Amendment to Increase Capitalization**

The increase in Surg's authorized shares from 5,000,000 to 50,000,000 shares, is being proposed in part to allow Surg to have sufficient authorized shares to complete the Merger of Chiral Quest into Surg's wholly owned subsidiary, CQ Acquisition, Inc. There are currently 4,348,720 of Surg's common stock outstanding. The Merger will require issuance of approximately 8,652,300 additional shares of Surg common stock, and the reservation of approximately 1,593,300 additional shares to accommodate the exercise of stock options and warrants which will be outstanding following the Merger.

The proposed increase in authorized shares is significantly more than is needed to complete the Merger. The proposed increase of authorized capital stock to 50,000,000 shares was negotiated between Surg and Chiral Quest, and is specified in the Merger Agreement. This increase will provide the Board of Directors of Surg with significant latitude to issue more shares of capital stock, without shareholder approval, to satisfy future capital needs or to enter into another strategic transaction in the future whether or not the Merger is effected. Such issuance would have the effect of diluting the voting interests of the shareholders of Surg. While there is no specific plan to issue new shares in addition to those to be issued in the Merger, additional new shares could be issued to satisfy Chiral Quest's additional financing requirements (See SUMMARY Risk Factors Risks Related to Chiral Quest's Operations ).

The proposed increase in the number of authorized shares of capital stock, and the flexibility in structuring the terms and conditions of those shares may be viewed as giving the Board of Directors the ability to make a takeover attempt more difficult. Management may use the shares to counter an offer by a bidder wanting to obtain control of Surg. For example, management could issue preferred shares with rights and preferences superior to common stock, such as superior voting rights, to persons friendly to management. Management has no current intention to issue preferred shares for that purpose.

**Recommendation of Board of Directors**

**MANAGEMENT RECOMMENDS A VOTE IN FAVOR OF THE PROPOSED AMENDMENT TO SURG'S ARTICLES OF INCORPORATION, AND THE PROXIES WILL BE VOTED IN FAVOR OF SUCH AMENDMENT UNLESS OTHERWISE DIRECTED.**

**Proposal No. 2**

**AMENDMENT TO ARTICLES OF INCORPORATION TO CHANGE NAME**

**General**

The Board of Directors is proposing that the Articles of Incorporation of Surg be amended to change the corporation's name from Surg II, Inc. to Chiral Quest, Inc.

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**Specific Language of Amendment to Change Name**

If approved by the shareholders, and if the Merger is consummated, the existing Article I of Surg's Articles of Incorporation would be amended in its entirety to read as follows:

ARTICLE I

NAME

The name of this Corporation is Chiral Quest, Inc.

**Reasons for Amendment**

The Merger Agreement requires that the proposed name change be presented to the Surg shareholders for adoption. The name change is intended to more closely reflect the new business of Surg following the Merger. Failure to adopt the proposal on the name change will not have any effect on the Merger. If the Merger is not effected, the name of Surg will not be changed.

**Recommendation of the Board of Directors**

**MANAGEMENT RECOMMENDS A VOTE IN FAVOR OF THE PROPOSED AMENDMENT TO SURG'S ARTICLES OF INCORPORATION, AND THE PROXIES WILL BE VOTED IN FAVOR OF SUCH AMENDMENT UNLESS OTHERWISE DIRECTED.**

**THE MERGER**

**Background of Surg**

Until January 2002, Surg was engaged in the business of designing, developing, manufacturing and marketing specialty medical and surgical wound drainage products under the name Surgidyne, Inc. In January 2002, Surg sold substantially all of its assets to Sterion Incorporated and changed its name to Surg II, Inc.

In May 2002, Entrx Corporation acquired 3,625,000 shares of Surg's common stock (145,000,000 shares of its previously authorized no par value common stock) for \$3,000,000. This represented approximately 90% of Surg's then outstanding shares of common stock, and gave Entrx Corporation effective control of Surg. In September 2002, Entrx Corporation acquired an additional 357,142 shares of Surg (14,285,680 shares of its previously authorized no par value common stock) for \$300,000.

In October 2002, Surg effected a one for 40 share reverse stock split. As a result, the total outstanding no par value shares of Surg became 4,348,720 shares of \$0.01 par value common stock, with 3,982,142 of those shares being held by Entrx Corporation. Shortly thereafter, Entrx Corporation distributed to its shareholders one Surg share for each two shares of Entrx Corporation common stock they held as of October 11, 2002. This resulted in the distribution of 3,791,576 Surg shares to Entrx Corporation's shareholders. Surg and Entrx Corporation effected the reverse stock split and the dividend in furtherance of the plan of Entrx Corporation to use Surg to attempt to provide value for its shareholders in a business which was different than that being conducted by Entrx Corporation.

**Background of Merger**

Wayne Mills, the President of Entrx Corporation since February 14, 2002, was introduced to Dr. Lindsay A. Rosenwald, the president and owner of Paramount Capital Investments LLC, by Samuel Levinson in the spring of 2000, with respect to a transaction unrelated to the Merger. Mr. Levinson is the president and principal owner of Key West Associates, LLC. Paramount Capital, Inc. was, and continues to be, active in providing financing and management for early stage biotechnology related companies.



## Edgar Filing: SURG II INC - Form DEF 14A

Mr. Mills and Kenneth Brimmer, a director of Entrx Corporation, met with Dr. Rosenwald in early March 2002 to discuss the possible involvement of Entrx Corporation with a biotechnology related company,

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consistent with Entrx Corporation's strategy to utilize its capital to develop its business and provide added value to its shareholders.

In early April 2002, Thomas D. Krosschell, a registered representative of Equity Securities Trading, a Minneapolis broker/ dealer, contacted Mr. Mills and informed him of the availability of Surg, a publicly held corporation with limited assets and liabilities, and no business operations, which might serve a