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August 24, 2000

VIA FACSIMILE

Mr. Michael Verne
Federal Trade Commission
Premerger Notification Office
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: **<u>Section 801.40 Analysis</u>**

Dear Mike:

This letter is intended to confirm my understanding of the advice you provided during a telephone conversation with me last week.

<u>STATEMENT OF FACTS</u>

Corporation A is negotiating the terms of an agreement with several investors. Under the terms of the proposed agreement, the proposed investors would form a new corporation ("Newco"). Upon the formation of Newco, Corporation A will contribute to Newco certain assets and intellectual property that it has been using to develop technology that it hopes to market commercially. Newco would also assume certain liabilities (e.g. outstanding vacation balances of transferred employees, open purchase orders for needed equipment) that would not exceed, in aggregate, $1 million. The investors agree to invest $20 million into Newco, without contingency. This $20 million investment will occur in two tranches. $15 million will occur at closing/formation of Newco. An additional $5 million in cash will come in six months after formation. Upon formation, the investor group will hold approximately 64% of the equity and Corporation A will hold approximately 36% of the equity of Newco.[1] The investor group is comprised of several different "persons" for H-S-R analysis. No person will have the power to appoint 50% or more of Newco's directors. Immediately upon the closing, Newco will distribute $5

[1] An additional block of common shares will be reserved for issuance to management. On a fully diluted basis, assuming the issuance of the common shares that are reserved for issuance to management, consultants and employees, Corporation A would hold 29% of the equity and the investor group would hold 51%.

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million in cash to Corporation A in the form of an equalization payment for its contribution. The additional $5 million in cash coming in six months later will also be passed through Newco to Corporation A to complete the equalization.

A third closing is also contemplated by the transaction agreement. If Newco is able to develop the technology sufficiently and is able to ship beta versions of products to two separate customers and receive revenues for such shipments, then the investor group will contribute an additional $10 million in cash to Newco. Corporation A has never developed and sold to a customer a product using the technology that is being contributed to Newco. Thus, Corporation A presently views the ability to ship products to two customers and receive payment as speculative. In any event, Corporation A does not anticipate that such shipments and revenues could be achieved prior to approximately one year from now, and could take longer, or potentially never be achieved.

CONTINGENT Contribution, NOT INCLUDED IN SIZE OF NEWCO OR SIZE OF TRANSACTION.

ANALYSIS

As we discussed, and you concurred, Section 801.40 which relates to formation of joint ventures and other corporations, is applicable to the foregoing transaction. The transaction meets the Size of Person Test under Section 801.40(b)(1), as well as the Size of Transaction Test under 15 U.S.C. § 18 a (a)(3)(A) (15% test). Accordingly, the governing issue for whether an H-S-R filing is required is whether any person will take back $15 million or more in Newco voting securities.[2]

The largest shareholder upon the formation of Newco will be Corporation A, which will hold approximately 36% of the total equity (or 29% on a fully diluted basis). Since the investor group is willing to pay $20 million, with no contingency, in order to obtain 64% (or 51% on a fully diluted basis) of the equity in Newco, this indicates that the parties have placed a value on Newco's equity interest. If the investor group is willing to pay $20 million for 64% of the equity, the total equity voting securities of Newco should be worth approximately $31.25 million. Since Corporation A will take back 36% of the equity securities in Newco, those securities should be worth approximately $11.25 million (i.e. $31.25 million x .36).

The relevant question that needs to be determined is what an arms-length purchaser would pay Corporation A to obtain its 36% interest in Newco after the formation transaction is completed. In this regard, the $20 million investment in exchange for 64% of the equity seems to place a value on the equity of Newco as of the time of closing. If Newco is able to develop beta versions of products and sell them to two different

[2] Absent an acquisition of a controlling interest, Section 802.20 exempts the acquisition of 15% of the voting securities, unless a person will hold shares in excess of $15 million. In this case, no person will obtain control, and the analysis therefore hinges on whether the $15 million test is met.

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customers, then the contingent payments from the investors would come in, raising their total amount paid for their equity interest to $30 million. However, as noted above, it is uncertain and speculative as to when or whether this additional $10 million will be invested by the investors. The contingent investment which will not come in unless the company is successful, and which would not occur for roughly a year at minimum, should be highly discounted in this evaluation analysis.

Of course, Corporation A would need to independently determine its view of the fair market value of the equity interest that it will receive at closing. If this fair market valuation is less than $15 million dollars, no H-S-R filing would be required. Corporation A can take into account the amount of fully diluted equity that will be received by the investors for their $20 million non-contingent contribution when determining the value of its equity interest in Newco.

If I have misunderstood our discussion and you believe that, contrary to this analysis, a filing would be required by one or more parties to this transaction even if Corporation A determines the fair market value of its post-formation holding is less than $15 million, please notify me at your earliest convenience. The parties will be proceeding with the transaction, relying on the analysis reflected in this letter.

Sincerely,

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AGREE - N. OVUKA CONCURS.
B. Michael Verne
8/29/00