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Verne, B. Michael

From: [redacted]

Sent: Thursday, December 04, 2008 1:07 PM

To: Verne, B. Michael

Subject: HSR Threshold Analysis

Hi Mike,
I have an HSR threshold analysis I would like to discuss with you regarding a transaction the facts of which are complicated enough that it probably would be helpful for you to have the details in written form before we talk. Please see below and I will give you a call today to discuss.

Companies Delta and Kappa, a wholly-owned subsidiary of Kappa parent, intend to form a joint venture to manufacture Product A, and the JV will be owned 60% by Delta and 40% by Kappa. The transaction will be consummated through a series of steps in which the parties will contribute cash and intellectual property in exchange for equity ownership in the JV. The JV, NewCo, will be an LLC and the right to the profits of NewCo and the right to the assets of NewCo upon dissolution will be in the same percentages as each of the parties' ownership interests.

Currently Kappa parent holds a subcontract to Company Zeta to produce Product A pursuant to Zeta's five-year, fixed-price, prime contract with the U.S. Government. The five-year contract is in the nature of a requirements contract and has no definite quantity of Product A to be delivered over the five years. The parties estimate that approximately 61 units will be produced pursuant to the existing contract. Kappa parent will produce Product A until NewCo is established and its production facilities are built (approximately an 18-24 month period) and will then transfer to NewCo (or Zeta will award to NewCo) the subcontract for production. The parties do not place any value on the subcontract because there is no value that is independent of, or not subsumed within, the product license and fees described in detail below. The parties estimate that Kappa parent will produce approximately 27 units of Product A, and NewCo will produce approximately 34 units under the existing contract. In addition to rights granted under the subcontract, NewCo will have the right to produce and sell additional units of Product A to the U.S. Government and to other customers after the phased transition from Kappa parent. NewCo's business plan posits that there may be sales of as many as 165 additional units of Product A, but none have been sold or are under contract.

Delta and Kappa have structured the transaction as follows: Delta will acquire an exclusive field of use license from Kappa parent for $58.3 million to produce Product A ("Product A License"). Delta will contribute the Product A License to NewCo. Kappa will pay Delta $23.3 million for a 40% interest in NewCo; Delta will retain a 60% interest. Over time, the parties will contribute up to $200 million in cash, split 60/40, with which NewCo will establish the manufacturing business.

Delta will enter into an intellectual property license agreement with NewCo covering presently undefined Delta IP manufacturing know how ("Delta Know How License"). The parties have not placed a value on this license and it will not carry any royalty or fee.

Once NewCo enters production, it will pay Kappa the following fees:

- $1 million per unit as a royalty for the right to sell units of Product A to the U.S. Government beyond the existing term of the subcontract (i.e. this fee does not apply to units of Product A produced under the existing U.S. Government contract, but applies only to future sales, if any, to the U.S. Government beyond the existing contract);
- $2.5 million per unit as a royalty for the right to sell to customers other than the U.S. Government; and
- $125,000 fee per unit of Product A that Newco produces (capped at 200 units) to compensate Kappa for its prior investment in certain improvements to a component of Product A that NewCo will purchase from a third party (i.e. recoupment of prior investment

costs).

There are currently no additional U.S. Government contracts or sales contracts for Product A, nor are any sales imminent, other than under the existing contract with the U.S. Government.

The transaction is not reportable whether viewed as multiple transactions comprising Delta's acquisition of the exclusive Product A License from Kappa parent and the formation of NewCo or as a single transaction comprising the formation of NewCo. We discuss the analysis for each alternative below:

1. Multiple Transactions:

Acquisition of Product A License: Delta's acquisition of the Product A License from Kappa parent for $58.3 million is below the $63.1 million size of transaction threshold. The parties' analysis places the actual value of this license at $35 million ($58.3 million, less $23.3 million). The structure of the deal was chosen to address Kappa's desire to meet certain accounting goals of Kappa parent while also deriving a 60/40 contribution to match the ownership goal for NewCo. The transaction is not reportable because the acquisition price (whether that is $35 million or $58.3 million) is below the threshold. Future sales of Product A beyond the existing U.S. Government contract are too indefinite and uncertain to include the $1 million or $2.5 million royalties in the value of the Product A License.

Formation of LLC: The formation of NewCo is exempt as to Delta under Rule § 802.4 because there are no non-exempt assets as to Delta. Delta's contribution of the Product A License and the Delta Know How License to NewCo are exempt intraperson transactions under Rule § 802.30(a) and (b). The cash contributed by Kappa to NewCo is not considered an asset under Rule § 801.21(a). Kappa's acquisition of a 40% interest in NewCo is not a reportable transaction as to Kappa because Kappa will not acquire a controlling interest in NewCo. Rule § 801.40(c)

2. Single Transaction:

If the formation of NewCo by Delta and Kappa is considered just one transaction, the formation of NewCo is not reportable. Delta acquires a controlling interest; however, the $63.1 million size of transaction threshold is not met. Delta's contributions of the Delta Know How License and cash are exempt as to Delta as the acquiring person under Rule § 802.30(c). Kappa's contribution of cash to NewCo is also exempt under Rule § 802.4 because cash is not considered an asset under Rule § 801.21(a). The only non-exempt asset as to Delta is the Product A License contributed to NewCo by Kappa. The value of the Product A License, as discussed above, is under the reporting threshold. Thus, the non-exempt assets as to Delta do not exceed the $63.1 million threshold; Delta's acquisition is exempt under Rule § 802.4. Therefore, the formation of NewCo is not reportable as to Delta. Kappa's acquisition of a non-controlling interest in NewCo is also not reportable. Rule § 801.40(c); see also Rule § 801.2(f)(1)(i) and Premerger Notification Practice Manual Interpretation # 80.

Thanks, [redacted]

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AGREE
12/4/08
[EXCEPT ITS 801.50
NOT 801.40]