BIDDING PROCEDURES

The following procedures (the "Bidding Procedures") will govern the competitive process run by XYZ CORP. and its debtor affiliates (XYZ CORP. and its debtor affiliates, collectively, "XYZ" or the "Debtors") to solicit proposals for the sponsorship and funding of a plan of reorganization for certain of the Debtors (the "Investment"), which may include the purchase of all or a portion of the Debtors' assets including, without limitation, the equity ownership interests of the Debtors (collectively, the "Acquired Assets").

Following completion of the competitive process, the applicable Debtors will seek approval of their restructuring or sale pursuant to a plan of reorganization (the "Plan").

The Bidding Procedures provided herein shall be the exclusive mechanism governing the auction process related to the Investment and Plan.

The Existing Plan of Reorganization

On ___________, 2010, all of the Debtors filed a Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (the "Amended Plan").

On ___________, 2010, the Debtors received an offer and proposal letter (the "Proposal Letter") from certain investors (together, the "Investors"). Pursuant to the Proposal Letter, the Investors agreed to commit, pending an executed agreement in writing with the Debtors that was consistent with the Proposal Letter, to step into the shoes of the existing shareholders of the Debtors.

On ___________, 2010, the Debtors executed a commitment letter with the Investors (the "Investors' Commitment Letter"), which contemplates the Investors sponsoring and funding a plan of reorganization based on the Investors' Commitment Letter. Pursuant to the Investors' Commitment Letter, the Debtors will file an Amended Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (the "Existing Plan") and the related Disclosure Statement on or before _____________, 2010 (the Existing Plan and the related Disclosure Statement together with the Investors' Commitment Letter, the "Existing Plan Related Agreements").

The Investors' Commitment Letter contemplated the commencement of an auction process pursuant to which the Debtors would solicit the highest or best proposals for the sponsorship and funding of a plan of reorganization.

Bidding Process

A. *Due Diligence*

The Debtors may afford any prospective acquirers and/or investors the opportunity to conduct a reasonable due diligence review in the manner determined by the Debtors, in their reasonable discretion after consultation with the Creditors' Committee and the Debt Parties (as each such term is defined below). Prospective acquirers and/or investors will be afforded the opportunity to conduct due diligence in a manner no less favorable than that provided to the Investors.

The Debtors and the Creditors' Committee have reached out to certain parties who have either expressed an interest in making a proposal or who the Debtors believe may have an interest in making a proposal with a request for a non-binding written indication of interest to sponsor a plan of reorganization for the Debtors. The Debtors shall also contact such other parties as suggested by the Creditors' Committee and the Debt Parties.

In addition, the Debtors have executed confidentiality agreements with interested parties who have requested further information. Upon the execution of an appropriate confidentiality agreement, those interested parties have been or shall be provided with access to certain information, through a virtual data room or otherwise. Interested parties may discuss their due diligence or any Proposal (as defined below) that they are considering or will be making with the Creditors' Committee or the Debt Parties, provided that the Creditors' Committee or the Debt Parties, as applicable, shall provide the Debtors with a reasonable opportunity to participate in any such discussions.

The Debtors shall coordinate all reasonable requests for additional information and due diligence access from interested parties. All due diligence requests by the interested parties shall be directed to [Investment Banker].

The Debtors shall provide the Creditors' Committee with weekly written updates regarding the due diligence efforts by interested parties.

B. ***<u>Public Announcement of Auction and Funding of Deposits</u>***

On ____________, 2010, the Debtors shall (i) issue a press release that contains a notice (the "<u>Notice of Auction</u>") of an auction for the Acquired Assets (the "<u>Auction</u>"), which Notice of Auction will include a list of all of the deadlines relating to the Auction and will have these Bidding Procedures attached as an exhibit and (ii) serve on all parties in interest and those parties who request notice, the Notice of Auction.

The Notice of Auction shall provide notice to all interested parties that, other than with respect to a Credit Bid (as defined below), in order to participate in the bidding process and the Auction and be deemed a Qualified Bidder (as defined below), each potential bidder (each, an "<u>Interested Party</u>") must provide a cash deposit in the amount of $__________ (the "<u>Deposit</u>") on or before ____________, 2010, with the Escrow Agent (as defined below) pursuant to an Escrow Agreement (as defined below) to be provided by the Debtors to the Interested Parties.

The Debtors shall publish a notice in the form attached hereto as Exhibit B in The Wall Street Journal within five (5) business days following approval by the Bankruptcy Court of these Bidding Procedures.

C. ***<u>Proposals</u>***

Each Interested Party, other than the Investors, must deliver a written and duly executed offer (a "Proposal"), **so as to be received by no later than 3:00 p.m. (Eastern Time) on ____________, 2010** ("Proposal Deadline") to the following address (the "Proposal Notice Party"):

[Investment Banker]

All forms of Proposals are permitted, whether as a plan sponsor/equity investor or as a purchaser of some or all of the Acquired Assets for cash consideration. In the event the Proposal involves a Plan, any such Plan may contain provisions specifically applicable to the Proposal and need not necessarily require substantive consolidation of the Debtors' estates or provide for confirmation of the Plan pursuant to section 1129(b) of the Bankruptcy Code. The Debtors and their professionals will deliver the Proposals received no later than one (1) business day following receipt of the Proposal to (i) advisors to the official committee of unsecured creditors (the "Creditors' Committee"), (ii) advisors for the holders of the obligations owed by the Debtors to the lending group, (the "Debt Parties") and (iii) advisors to the Investors, as follows:

To the Creditors' Committee:

[Appointed Attorneys]

To the Debt Parties:

[Lender's Counsel]

To the Investors:

[Investors Counsel]

Each Proposal must:

1. state that such Interested Party offers to purchase the Acquired Assets and fund a Plan;

2. state that such Interested Party's Proposal is not subject to any further due diligence and that such Interested Party has obtained all necessary financing and approvals;

3. include evidence of authorization and approval from the Interested Party's board of directors (or comparable governing body) with respect to the submission, execution, delivery and closing of the Proposal and transactions contemplated thereby, including evidence of a binding commitment to provide financing and specifically listing any conditions to any such financing commitment;

4. fully disclose the identity of each party that will be participating in connection with such Proposal, and the complete terms of any such participation;

5. contain a detailed overview of the terms of the Interested Party's sponsorship of a Plan for the applicable entities, which terms must include, to the extent applicable to the Interested Party's Proposal, a detailed pro forma capitalization, ownership, amount of a new money investment and all sources of recovery to the holder of indebtedness and the other non-insider prepetition creditors and contain as much detail as possible on proposed structure, including a list of the relevant entities to be included in any alternative plan;

6. not include (i) a right to request or entitlement to any commitment payment, break-up fee or similar type of payment or (ii) reimbursement of fees and expenses other than in connection with the implementation of the Proposal if the Interested Party is the Successful Bidder (as defined below);

7. contain a description of the financial assumptions and any other assumptions utilized in each Interested Party's Proposal, including estimated transaction costs, and any major underwriting assumption(s) upon which each Interested Party may have based its Proposal, including working capital, capital expenditure requirements and impact of proposed structure;

8. contain evidence of the source(s) of equity and/or debt financing for the Interested Party's Proposal, including the parties to provide financing, their contact information, and a description of each sponsor and any additional party or parties funding the Plan and such party's financial position;

9. contain confirmation that the Proposal has received any necessary internal approvals to make a binding Proposal;

10. state each Interested Party's and any other sponsor's experience in the related to the Acquired Assets, industry, including ownership and management of such Assets, as well as any other information that it thinks could be important to the Debtors in their decision-making process regarding the Proposal;

11. state the specific person(s) whom the Debtors' financial advisors should contact in the event that the Debtors have any questions or wish to discuss the Proposal; and

12. include a mark-up of the Existing Plan Related Agreements and a mark-up of an investment and standby purchase agreement to the extent practicable based upon the structure of the Interested Party's Proposal.

As a condition to maintaining its status as a Qualified Bidder (as defined below), the Investors must, if they have not already done so, satisfy the conditions described in subparagraphs (1) to (12) of this paragraph C on or prior to the Proposal Deadline.

> Each Interested Party providing a Proposal shall be deemed to acknowledge and represent that it has had an opportunity to conduct due diligence on the Debtors prior to making its Proposal; that it has relied solely upon its own independent review, investigation and/or inspection of any documents and/or the assets in making its Proposal; and that it did not rely upon any written or oral statement, representations, promises, warranties or guaranties whatsoever, whether express, implied, by operation of law or otherwise, regarding the Debtors, or the completeness of any information provided in connection therewith, other than any representation or warranty contained in any Existing Plan Related Agreements.

Within one (1) business day following entry by the Bankruptcy Court of an order approving the Bidding Procedures contained herein, the Debtors shall provide copies of all proposals or other indications of interest for the Acquired Assets received by the Debtors prior to entry of such order to the professionals for the Creditors' Committee, the Debt Parties and the Investors.

FOR THE AVOIDANCE OF DOUBT, ANY AND ALL PARTIES SHOULD BE AWARE THAT ANY PARTY THAT DOES NOT SUBMIT A PROPOSAL BY THE PROPOSAL DEADLINE WILL NOT BE ALLOWED TO (1) PARTICIPATE IN THE AUCTION UNDER ANY CIRCUMSTANCES OR (2) SUBMIT ANY OFFER AFTER THE PROPOSAL DEADLINE.

D. ***Deposits***

The submission of a Proposal by the Proposal Deadline shall and must be accompanied by the Deposit with an escrow agent selected by the Debtors (the "Escrow Agent") pursuant to the escrow agreement to be provided by the Debtors to the Interested Parties (the "Escrow Agreement"). The submission of a Proposal and a Deposit by the Proposal Deadline shall constitute binding and irrevocable offers. A Deposit shall not be required in respect of any Credit Bid.

E. ***Review of Proposals***

The Debtors will review those Proposals timely submitted and engage in negotiations with those prospective acquirers and/or investors that submitted Proposals complying with the proceeding paragraphs and as they deem appropriate in the exercise of their business judgment, based upon the Debtors' evaluation of the content of each Proposal as well as other commercial and competitive considerations. The Debtors will provide copies of the Proposals promptly upon receipt to the Creditors' Committee, the Debt Parties, and the Investors, and will consult with the Creditors' Committee and the Debt Parties in the Debtors' review and analysis of the Proposals. The Debtors retain the right in the exercise of their business judgment to determine whether an Interested Party that submitted a Proposal may participate in the Auction. If the Debtors determine that an Interested Party that submitted a Proposal may not participate in the Auction, the Creditors Committee and the Debt Parties retain the right to object to the Bankruptcy Court on an emergency basis regarding such determination.

The Debtors will select, in the exercise of their business judgment after consultation with the Creditors' Committee and the Debt Parties, those Proposals qualifying to proceed in the process on or before **_____________, 2010**. In evaluating the Proposals, the Debtors will take into consideration, among other factors, the form, value and certainty of recovery provided to the holder of the indebtedness owed to the Debt Parties and other non-insider prepetition creditors, transaction structure and execution risk, including conditions to closing, availability of financing and financial wherewithal to meet all commitments under the Proposal, approvals required, and the Interested Party's ability to manage the Debtors' business.

After review of the timely submitted Proposals, the Debtors shall determine, in the exercise of their business judgment after consultation with the Creditors' Committee and the Debt Parties, if any such Interested Parties has submitted a Proposal that qualifies to participate in the Auction (each such party, a "Qualified Bidder" and a "Qualified Proposal," respectively). After determining that an Interested Party is a Qualified Bidder and qualifies to participate in the Auction in accordance with these Bid Procedures, the Debtors will notify the party in writing, on or before **_____________, 2010**, with a copy to the Creditors' Committee, the Debt Parties, and the Investors. On or before **_____________, 2010,** the Debtors shall provide the Creditors' Committee and the Debt Parties with their analysis of all of the Proposals and their rationale for determining that any Proposal either qualified or did not qualify to participate in the Auction.

Only those Proposals that (i) were submitted on or before the Proposal Deadline, (ii) provide incremental value to the holder of the indebtedness owed to the Debt Parties and other non-insider prepetition creditors as compared to the Existing Plan Related Agreements, (iii) state that they are binding and irrevocable offers and are otherwise consistent with these Bidding Procedures and (iv) are accompanied by the Deposit (other than in respect of a Credit Bid) that was submitted on or before _____________, 2010, may be deemed Qualified Proposals.

FOR THE AVOIDANCE OF DOUBT, ANY AND ALL PARTIES SHOULD BE AWARE THAT, ABSENT AN ORDER OF THE BANKRUPTCY COURT, ANY PARTY THAT IS NOT DETERMINED TO BE A QUALIFIED BIDDER BY _____________, 2010 WILL NOT BE ALLOWED TO (1) PARTICIPATE IN THE AUCTION UNDER ANY CIRCUMSTANCES OR (2) SUBMIT ANY OFFER AFTER THE PROPOSAL DEADLINE.

The Debtors reserve the right in the exercise of their business judgment, after consultation with the Creditors' Committee and the Debt Parties, to reject any Proposal if the Debtors determine that such Proposal does not constitute a Qualified Proposal or is otherwise inadequate or insufficient or is otherwise contrary to the best interests of the Debtors.

Notwithstanding anything in these Bidding Procedures, (i) the Investors are deemed Qualified Bidders, and the Existing Plan Related Agreements shall be deemed a Qualified Proposal for all applicable purposes under these Bidding Procedures with respect to the

Auction and otherwise and (ii) the Debt Parties reserve the right to credit bid all or any portion of the claims held by them (the "Credit Bid") at the Auction and is deemed to be a Qualified Bidder for purposes of any such Credit Bid.

Between the date the Debtors notify an Interested Party that it is a Qualified Bidder and the Auction, the Debtors may discuss, negotiate or seek clarification of any Qualified Proposal from a Qualified Bidder; provided, however, the Debtors shall consult with the Creditors' Committee and the Debt Parties with respect to such actions. Without the written consent of the Debtors, a Qualified Bidder may not modify, amend or withdraw its Qualified Proposal, except for proposed amendments to increase the purchase price or otherwise improve the terms of the Qualified Proposal for the Debtors, during the period that such Qualified Proposal remains binding as specified herein; provided, however, that any Qualified Proposal may be improved at the Auction as set forth herein. The determination of the Qualified Bidders shall become irrevocable and unreviewable once the Auction has commenced.

The Auction

A. ***Notice of Auction***

If the Debtors determine in the exercise of their business judgment, after consultation with the Creditors' Committee and the Debt Parties, that they have received a Qualified Proposal in addition to the Existing Plan Related Agreements by the Investors, the Auction will be held **on _____________, 2010 at 10:00 a.m.** (prevailing Eastern Time) at the offices of [ ]. **On or before _____________, 2010 at 5:00 p.m**. (prevailing Eastern Time), the Debtors shall provide each Qualified Bidder (including the Investors), the Creditors' Committee and the Debt Parties with the following: (1) written notice that the Auction is proceeding in accordance with the notice of Auction previously published by the Debtors, (2) a copy of the Qualified Proposal the Debtors have determined constitutes the highest or otherwise best offer among the Qualified Proposals and with which they intend to commence the Auction (the "Pre-Auction Successful Bid") and (3) each of the Qualified Proposals.

The Auction may be adjourned as the Debtors deem appropriate in the exercise of their business judgment, after consultation with the Creditors' Committee and the Debt Parties. Reasonable notice of such adjournment and the time and place for resumption of the Auction shall be given to all of the Qualified Bidders.

B. ***Attendance and Participation in the Auction***

a. In addition to the Debtors and their advisors, the only parties eligible to participate in the Auction shall be: (i) the Investors and their representatives and advisors; (ii) representatives and advisors of the Creditors' Committee; (iii) representatives and advisors of the Debt Parties; (iv) those Qualified Bidders who have submitted a Qualified Proposal to the Debtors (as well as such Qualified Bidder's advisors and representatives); and (v) the Office of the United States Trustee for the Southern District of New York. The

Investors and the Qualified Bidders shall appear in person at the Auction, or through a duly authorized representative.

b. Each Qualified Bidder shall be required to confirm that it has not engaged in any collusion with respect to the bidding or the Auction.

c. Each Qualified Bidder shall have provided the Deposit (other than in respect of a Credit Bid).

C. ***<u>The Auction Process</u>***

The Auction shall run in accordance with the following procedures:

a. The Debtors and their respective professionals shall direct and preside over the Auction, provided that the Debtors shall consult with the Creditors' Committee and the Debt Parties on matters throughout the Auction.

b. On or before **______________, 2010**, each Qualified Bidder who has timely submitted a Qualified Proposal (as determined by the Debtors in accordance with these Bidding Procedures) must inform the Debtors whether it intends to attend the Auction; provided that in the event a Qualified Bidder does not attend the Auction, such Qualified Bidder's Qualified Proposal shall nevertheless remain fully enforceable against such Qualified Bidder until the date of the selection of the Successful Bid (as defined below) at the conclusion of the Auction. The Debtors shall promptly inform the Creditors' Committee and the Debt Parties of the names of the Qualified Bidders who have informed the Debtors that they will be attending the Auction.

c. All Qualified Bidders who have timely submitted Qualified Proposals will be entitled to be present for all Subsequent Bids (as defined below) at the Auction with the understanding that the identity of each Qualified Bidder at the Auction will be fully disclosed to all other Qualified Bidders at the Auction and that all material terms of each Subsequent Bid will be fully disclosed to all other Qualified Bidders throughout the entire Auction; provided that all Qualified Bidders wishing to attend the Auction must have at least one individual representative with authority to bind such Qualified Bidder attending the Auction in person. All proceedings at the Auction shall be conducted before and transcribed by a court stenographer.

d. At the commencement of the Auction, the Debtors shall announce and describe the terms of any modification to the Pre-Auction

Successful Bid previously identified by the Debtors on **_____________, 2010**, as determined by the Debtors in accordance with these Bidding Procedures.

e. The Debtors may employ and announce at the Auction in the exercise of their business judgment and in consultation with the Creditors' Committee and the Debt Parties additional procedural rules that are reasonable under the circumstances to obtain the highest or best Successful Bid (e.g., the amount of time allotted to make Subsequent Bids (as defined below)) for conducting the Auction, provided that such rules are (i) not inconsistent with these Bidding Procedures, the Bankruptcy Code, or any order of the Bankruptcy Court, (ii) not unfairly prejudicial or place an undue burden on any individual Qualified Bidder, (iii) and (iii) disclosed to each Qualified Bidder at the Auction.

f. Bidding at the Auction will begin with the Pre-Auction Successful Bid and continue, in one or more rounds of bidding, so long as during each round at least one subsequent bid (a "Subsequent Bid") is submitted by a Qualified Bidder that the Debtors determine in the exercise of their business judgment and in consultation with the Creditors' Committee and the Debt Parties, (i) in the case of the first round, is a higher or otherwise better bid than the Pre-Auction Successful Bid by an amount of not less than $__________ and (ii) in the case of subsequent rounds, is a higher or otherwise better bid by the minimum bid increment set by the Debtors for each such round than the best bid of the previous round. Each Qualified Bidder must submit a Subsequent Bid that satisfies the minimum bid increment in each round of bidding to continue participating in the Auction.

g. The Debtors shall announce the material terms of each Subsequent Bid at the Auction, and shall disclose its valuation of the total consideration (as adjusted by the Debtors to convert any non-cash portion of a Subsequent Bid to a cash equivalent as determined by the Debtors in the exercise of their business judgment after consultation with the Creditors' Committee and Debt Parties) offered in each such Subsequent Bid (and the basis for its determination) in order to (a) confirm that each Subsequent Bid meets the minimum bid increment set by the Debtors for the round in which such Subsequent Bid was submitted and (b) to provide a floor for further Subsequent Bids.

D. ***Identification of the Successful Bidder***

At the close of the Auction, the Debtors, in the exercise of their business judgment after consultation with the Creditors' Committee and the Debt Parties, shall identify which Qualified Bidder has the highest or otherwise best bid (the "Successful Bid," and such bidder, the "Successful Bidder"), which will be determined by considering, among other things:

1. The Qualified Proposal that is preferred by the Creditors' Committee and the Debt Parties.

2. The extent to which any requested modifications to the Existing Plan Related Agreements are likely to delay the closing, and the likely cost to the Debtors of any such modifications or delay.

3. The total consideration (as adjusted by the Debtors to convert any non-cash portion of a Qualified Proposal to a cash equivalent) to be received by the holder of the indebtedness owed to the Debt Parties and the other non-insider prepetition creditors under the terms of each Qualified Proposal.

4. Each Qualified Bidder's ability to timely close a transaction and make any deferred payments, if applicable.

5. The net benefit to the holders of the indebtedness owed to the Debt Parties and the other non-insider prepetition creditors and the likely timing and amount of distributions to the holders of the indebtedness owed to the Debt Parties and the other non-insider prepetition creditors resulting from each proposal.

In announcing the Successful Bid, the Debtors shall announce the material terms of such bid, the basis for determining the total consideration (as adjusted by the Debtors to convert any non-cash portion of the Successful Bid to a cash equivalent) offered and the resulting calculated benefit of such bid to the holder of the indebtedness owed to the Debt Parties and the other non-insider prepetition creditors. Upon the close of the Auction, the Debtors shall announce the Successful Bidder, and such Successful Bidder shall promptly thereafter submit fully executed revised documentation memorializing the terms of the Successful Bid to the Debtors, the Creditors' Committee and the Debt Parties. The Successful Bid may not be assigned to any party.

If no Auction is held, then the proposal of the Investors as represented by the Existing Plan shall be deemed to be the Successful Bid and the Investors shall be deemed to be the Successful Bidder and the Debtors will proceed to effectuate the transactions as set forth in the Existing Plan Related Agreements; provided, however, that nothing in these Bidding Procedures in any way limits the ability of the Debtors and the Investors to mutually agree on improvements, after consultation with the Creditors' Committee and the Debt Parties, in the terms of the Existing Plan Related Agreements.

Return of Deposits

The Deposits submitted by Qualified Bidders will be held in escrow by the Debtors' Escrow Agent. Each Deposit will be forfeited to the Debtors if (a) the applicable

Qualified Bidder attempts to modify, amend or withdraw its Qualified Proposal, except for proposed amendments to increase the purchase price or otherwise improve the terms of the Qualified Proposal for the Debtors, during the time the Qualified Proposal remains binding and irrevocable under these Bidding Procedures or (b) the Qualified Bidder is selected as the Successful Bidder and fails to consummate the Plan according to these Bidding Procedures. The Escrow Agent shall release the Deposit by wire transfer of immediately available funds to an account designated by the Debtors two (2) Business Days after the receipt by the Escrow Agent of a written notice by a Debtor authorized officer stating that the Qualified Bidder has breached or failed to satisfy its obligations or undertakings.

The Debtors shall promptly return to the applicable Qualified Bidder any Deposit, plus any interest accrued thereon, accompanying (a) a Proposal that the Debtors determine in accordance with these Bidding Procedures not to be a Qualified Proposal, and (b) any Qualified Proposal that the Debtors do not select as the Successful Bid at the Auction, two (2) Business Days after the close of the Auction.

The Deposit of the Successful Bidder shall be applied against the cash investment of the Successful Bidder upon the consummation of the plan proposed in the Successful Bid.

<u>Plan Process</u>

After selecting the Successful Bid, the Debtors, in consultation with the entity or entities which submitted the Successful Bid, and with the Creditors' Committee and the Debt Parties, will prepare and file a revised plan and related disclosure statement with the United States Bankruptcy Court for the Southern District of New York to effectuate the terms of the Successful Bid. The hearing to consider the adequacy of the Disclosure Statement for the Successful Bid shall occur not later than ______________, 2010, unless otherwise agreed by the Debtors and the Successful Bidder.

<u>Reimbursement of Expenses</u>

The Successful Bidder shall be entitled to reimbursement of reasonable expenses up to $_________ in the event that the revised Plan that reflects the Successful Bid is withdrawn or the investment agreement relating to such Plan is terminated because the Debtors have determined to pursue a Plan or other transaction based on an alternative bid or proposal for any of the Acquired Assets.

<u>Reservation of Rights</u>

The Debtors reserves the right, subject to the exercise of their business judgment and after consultation with the Creditors' Committee and the Debt Parties, during the Auction to alter or terminate these Bidding Procedures, to alter the assumptions set forth herein, and/or to terminate discussions with any and all prospective acquirers and investors at any time and without specifying the reasons therefore, to the extent not inconsistent with the Bidding Procedures set forth herein.

End of Auction Process

Following the selection of the Successful Bid, (A) the Auction shall be closed, (B) the Debtors shall (i) immediately cease and cause to be terminated any ongoing solicitation, discussions and negotiations with respect to any other bids or proposals for the Acquired Assets and (ii) not solicit any inquiries or proposals, or enter into any discussions, negotiations, understandings, arrangements or agreements, relating to any other bid or proposal for the Acquired Assets, and (C) no additional bids or proposals for the Acquired Assets will be accepted or considered by the Debtors unless and until the earlier of (1) the termination of the investment agreement by and among the Successful Bidder and the Debtors and (2) entry of an order of the Bankruptcy Court denying confirmation of the Plan sponsored by the Successful Bidder.

Dated: ______________, 2010

Bid Solicitation

PERSONAL AND CONFIDENTIAL

[Date]

[Name]
[Company]
[Street]
[City, State Zip]

Dear Mr./Ms.[ ]:

On behalf of _________________ (the "Company"), you are invited to submit a firm and binding proposal (the "Proposal") in connection with your interest in acquiring the Company. The Proposal should be submitted in conformity with the guidelines set forth below.

The Company requests that you submit your Proposal in writing to _________________ ("Investment Advisor") no later than 3:00 PM, Eastern Standard Time, on Wednesday, _________________. Additionally, please submit clean and marked copies of the Purchase Agreement and related documents (the "Agreement") by the same deadline. An electronic copy of the Agreement will be provided for this purpose. Proposals should be addressed to:

Investment Advisor
____
____

Attention:
E-mail:
Telephone:
Facsimile:

Investment Advisor will evaluate all Proposals and will attempt to respond on a timely basis. While Investment Advisor may contact you to clarify your Proposal (if needed), Company will consider your Proposal to be your best and final offer. Please be advised that your Proposal should address the following matters:

1. <u>Purchase Price</u>: Please include the amount and form of consideration, in U.S. Dollars, that you would be prepared to pay for 100% of the Company, assuming a debt free, cash free balance sheet.

2. <u>Sources / Certainty of Financing</u>: Please include a sources and uses table including the proposed capital structure, including funded debt, new equity and management rollover, if applicable. Your Proposal should include firm commitment letters from your financing sources, if any. Your Proposal should not be subject to any financing contingencies.

3. Documentation / Terms of Agreement: Your Proposal should include a copy of the Agreement, marked to reflect those changes, if any, which if incorporated would allow you to execute the Agreement. All changes should be in the form of specific language changes and should be marked on the electronic copy of the Agreement provided to you. Please note that substantive changes to the Agreement may be viewed as creating a discount to the nominal value of your Proposal. In particular, any changes that could delay or decrease the certainty of closing will place your Proposal at a disadvantage. You are encouraged to call Company's attorneys to clarify any issues you may have related to the Agreement in advance of submitting your Proposal.

4. Conditions: Prospective purchasers should have completed all of their due diligence prior to submitting their Proposal. Your Proposal should not be subject to the completion of additional business, legal or other due diligence. Please contact Investment Advisor as soon as possible to make any necessary arrangements to complete your due diligence, if necessary.

5. Authorization / Approvals: An officer who is fully authorized to bind your company to the terms of the Agreement should sign your Proposal. In addition, all required corporate approvals should be obtained prior to submitting your Proposal. Please confirm that all such approvals have been obtained.

6. Employment Agreements: Please discuss in your Proposal any expectations of future employment of Company employees, including, specifically, any preferences or requirements for certain employees to agree to be employed by you or otherwise enter into employment and/or non-compete agreements.

7. Key equity terms: Please provide a summary of key equity terms (i.e. rollover, promote, vesting provisions, option pool) applicable to both Company management and its employees.

8. Other Considerations: Please identify any other relevant information that might influence your ability to consummate a transaction in a timely fashion.

Company reserves the right, in its sole discretion, to modify the terms and conditions of the invitation made by this letter and the terms and conditions set forth in the Agreement at any time. Company also reserves the right to reject any and all definitive Proposals without providing any reasons therefore and to withdraw all or part of the Company from sale.

Company reserves the right to consider all factors in the determination of the successful Proposal and to deal with any party individually or simultaneously with other prospective purchasers. Neither the identity of any prospective purchaser nor any details of the Proposals will be disclosed to any other prospective purchasers.

All discussion regarding a Proposal should be directed through Investment Advisor. Under no circumstances should the Company or any of its directors, officers, employees, consultants or shareholders be contacted directly.

Although Investment Advisor believes that all the information provided is accurate, the Company, Investment Advisor disclaims any representations or warranties with respect to the accuracy or completeness of such information. The only representations or warranties upon which you may rely with respect to Company will be those set forth in the executed Agreement.

The existence and content of this letter are subject to the Confidentiality Agreement relating to the proposed transaction that was previously executed and delivered by you. The Company's management has asked us to convey to you the importance they attach to keeping the matters covered by this letter and all other Evaluation Material strictly confidential.

Investment Advisor will be available to discuss these procedures with you in order to provide guidance as to the form and content of your contemplated Proposal. If you have any questions regarding this process, please feel free to contact Investment Advisor. On behalf of Company, we appreciate your interest in this opportunity and look forward to working with you in this process.

ENGAGEMENT LETTER

[Date]

[Name of Company]
[Address of Company]

Attention: [Name]
[Title]

Dear _____________:

This letter agreement confirms the engagement (the “Engagement”) of ________________ (“Advisor”) subject to the terms and conditions hereof and of all attachments hereto (this letter agreement and the other attachments hereto, the “Agreement”), to provide the services described in Section 1 below in connection with the transaction described herein and in the Term Sheet (the “Transaction”) for _____________ (the “Company”).

[Description of Transaction]

1. Proposed Services. Subject to the conditions precedent set forth below, Advisor agrees:

(i) to assist the Company in structuring the Transaction,

(ii) to perform such investment banking and financial advisory services as Advisor and the Company from time to time may agree upon in writing.

2. Not a Commitment. This Agreement does not constitute a commitment by Advisor to lend money, underwrite the Transaction, purchase securities or other assets, or provide financing to the Company or arrange financing for the Company from third parties or an agreement by Advisor to prepare, negotiate, execute or deliver such a commitment. The delivery of such a commitment would be subject to, among other things, satisfaction of the conditions precedent set forth below.

3. Conditions Precedent. Advisor’s obligations hereunder are expressly subject to the satisfaction of the following:

(i) the completion of such due diligence review as Advisor deems advisable, the results of which are satisfactory to Advisor;

(ii) the negotiation and execution of mutually satisfactory documentation for the Transaction (collectively, the “Program Documents”);

(iii) in Advisor’s determination, the absence of (A) any material adverse change in the business, condition (financial or otherwise), operations or prospects of the seller since _____________, and (B) any material adverse circumstance, change or condition (including the continuation of any existing condition) in the financial or capital markets;

(iv) the accuracy and completeness of all representations that the Company makes to the Advisor and all information that the Company furnishes to Advisor;

(v) the Company's compliance with the terms of this Agreement, including, without limitation, the payment in full of all fees, expenses and other amounts payable under this Agreement; and

(vi) the receipt of such approvals and legal opinions as Advisor may deem necessary or advisable, in form and substance satisfactory to Advisor.

4. Fees. The Company agrees to pay the fees set forth in a separate schedule to be agreed upon by Company and Advisor. The fees described therein are exclusive of (i) legal fees and expenses, (ii) other fees and expenses related to the Transaction, including any rating agency reviews or valuation services and (iii) fees for additional services the Company may reasonably request from Advisor or other parties or both.

5. Costs and Expenses. The Company agrees to reimburse Advisor on demand for (i) any costs and expenses incurred by Advisor in performing its obligations hereunder, including, without limitation, all reasonable fees and disbursements of Advisor's counsel and counsel for [any other covered party], whether or not the Program Documents are executed, the Transaction is consummated or the Engagement is terminated and (ii) any costs and expenses (including, without limitation, fees and disbursements of counsel) incurred by Advisor in connection with the enforcement of any of its rights and remedies hereunder.

6. Payments. Each of the fees and other amounts payable by the Company hereunder will be non-refundable when paid and shall not be subject to counterclaim or set-off for, or be otherwise affected by, any claim or dispute relating to any matter not related to the Engagement.

7. Acknowledgements. The Company recognizes and confirms that Advisor, in acting pursuant hereto, may be using information in public reports and information provided by others and the Company, and that Advisor does not assume responsibility for the accuracy or completeness of such information.

The Company acknowledges that it has been advised that (i) Advisor is not in the business of providing and is not providing (and the Company is not relying on Advisor for) legal, accounting, regulatory or tax advice, (ii) there may be legal, accounting, regulatory or tax risks associated with the Transaction, (iii) the Company should receive separate and qualified legal, accounting, regulatory and tax advice and it should make an independent analysis and decision regarding the Transaction based on such advice and (iv) the Company should apprise the Company's senior management as to the legal, accounting, regulatory and tax advice (and, if applicable, risks) associated with the Transaction and Advisor's disclaimers as to these matters.

8. Cooperation. It is understood that the Company will furnish Advisor with all information and data that Advisor reasonably deems appropriate in connection with the Engagement. The Company agrees to do those things that are reasonable and necessary to assist Advisor to facilitate the consummation of the Transaction.

9. Indemnification. The Company agrees to indemnify Advisor and the other persons and entities referred to in Schedule 1 hereto for certain liabilities and expenses, or contribute to Advisor and such other persons and entities payments with respect thereto, in accordance with the provisions in Schedule 1 hereto, which provisions are incorporated by reference herein and made an integral part hereof.

10. Confidentiality. By accepting delivery of this Agreement, the Company agrees not to disclose to any person or entity the terms of this Agreement, or the Program Documents (including, without limitation, any specific pricing information provided by Advisor or the amount or terms of any fees payable to Advisor in connection with the Transaction), the proposal or structure of the Transaction, any related structures developed by Advisor for the Company, any related analyses, computer models, information or documents, any written or oral reports from Advisor to the Company or any related written information or the existence or status of any ongoing negotiations between the Company and Advisor concerning the Transaction (collectively, the "Product Information"), except (i) to its and its affiliates' officers, directors, employees, agents, accountants, legal counsel and other representatives (collectively, the "Company Representatives") who have a need to know the Product Information in connection with the Transaction and who either (a) agree to be bound by the provisions of this Section applicable to the Company or (b) owe a duty of trust or confidentiality to the Company, (ii) in connection with any action or proceeding related to, or the exercise of any remedies under, the Transaction or this Agreement, (iii) to the extent required by applicable law, regulation, subpoena, court order or other legal process or (iv) to any other person or entity with Advisor's prior written consent. The Company will be responsible for any failure of any Company Representative to comply with the provisions of this Section applicable to the Company.

Product Information shall not include information that (i) is or becomes publicly available other than through a breach of this Agreement, or (ii) was or becomes available to the receiving party on a non-confidential basis from a source that is not known to such receiving party to be subject to a confidentiality agreement with Advisor.

Notwithstanding any other provision in this Agreement, Advisor hereby confirms that the Company and the Company Representatives shall not be limited from disclosing the U.S. tax treatment or U.S. tax structure of the Transaction.

[Advisor agrees to be bound by the confidentiality provisions set forth in Schedule 2 hereto, which provisions are incorporated by reference herein and made an integral part hereof.]

11. Potential Conflicts; Principal Transactions. The Company acknowledges that Advisor may provide financing, equity capital, financial advisory and/or other services to parties whose interests may conflict with the Company's interests. Consistent with Advisor's policy to hold in confidence the affairs of its customers, Advisor will not furnish confidential information obtained from the Company to any of Advisor's other customers. Furthermore, Advisor will not make available to the Company confidential information that Advisor obtained or may obtain from any other person.

The Company further acknowledges that (i) Advisor's engagement hereunder is as an independent contractor and not in any other capacity, (ii) Advisor is not acting as an agent or fiduciary for the Company, its management, stockholders, creditors or any other person, in connection with the Transaction, (iii) the Company is solely responsible for making its own judgments in connection with the Transaction (irrespective of whether Advisor has advised or is currently advising the Company on related or other matters), and has the capacity to evaluate and negotiate the terms of the Transaction on an arms' length basis, and (iv) Advisor may act as principal in various aspects of the Transaction. The Company waives any claim against Advisor based upon any conflict of interest that Advisor may have with regard to acting under this Agreement and as a principal in the Transaction.

12. Exclusivity. The Company agrees that no other person or entity will be authorized or retained during the term of the Engagement to perform substantially similar services on its behalf in connection with the Transaction.

13. Termination. The Engagement shall terminate on the earliest of (i) the execution of mutually satisfactory Program Documents, (ii) the written notice of the Company to Advisor, or of Advisor to the Company, that the Engagement is terminated and (iii) __________, __. The provisions of the Sections entitled "Fees", "Costs and Expenses", "Payments", "Indemnification", "Confidentiality", "Patriot Act", "Accounting/Disclosure", Governing Law; Miscellaneous", ["Cross-Border Provisions",] and "Waiver of Jury Trial" shall survive the termination of the Engagement, except to the extent, and only to the extent, such provisions are explicitly covered in the Program Documents.

14. Patriot Act. Advisor hereby notifies the Company that pursuant to the requirements of the USA PATRIOT Act (Title III of Pub. L. 107-56 (signed into law October 26, 2001)) (the "Act"), Advisor is required to obtain, verify and record information that identifies the Company and its affiliates participating in the Transaction, which information includes the name and address of the Company and such affiliates, and other information that will allow Advisor to identify the Company and such affiliates in accordance with the Act.

15. Accounting/Disclosure. The Company will notify Advisor of the Company's accounting treatment for the Transaction prior to its closing.

[16. Cross Border Provisions. All payments by the Company hereunder shall (i) be made in U.S. Dollars in New York, New York or in the currency and country in which such costs and expenses were incurred, as specified by Advisor, and (ii) be made free and clear of and without deduction for any and all present or future applicable taxes, levies, imposts, deductions, charges or withholdings, and all liabilities with respect thereto (with appropriate gross-up for withholding taxes).

With respect to all matters relating to this Agreement, the Company hereby irrevocably (a) submits to the non-exclusive jurisdiction of any New York State or Federal Court sitting in the State of New York, County of New York, U.S.A.; (b) agrees that all claims related hereto may be heard and determined in such courts; (c) waives the defense of an inconvenient forum; (d) agrees that a final judgment of such courts shall be conclusive and may be enforced in any other jurisdiction by suit on the judgment or in any other manner provided by law; and (e) waives any immunity (sovereign or otherwise) from jurisdiction of any court or from any legal process or set-off that it or its properties or assets has or may acquire. The Company hereby irrevocably designates [INSERT NAME AND ADDRESS OF THE COMPANY'S PROCESS AGENT LOCATED IN THE U.S.] as agent for service of process.

If, for the purposes of obtaining judgment in any court, it is necessary to convert a sum due hereunder in U.S. Dollars into another currency, the parties hereto agree, to the fullest extent that they may effectively do so, that the rate of exchange used shall be that at which in accordance with normal banking procedures Advisor could purchase U.S. Dollars with such other currency on the business day preceding that on which final judgment is given. The Company's obligation in respect of any sum due from the Company to Advisor hereunder shall, notwithstanding any judgment in a currency other than U.S. Dollars, be discharged only to the extent that on the business day following its receipt of any sum adjudged to be so due in such other currency, Advisor may, in accordance with normal banking procedures, purchase (and remit in New York, New York) U.S. Dollars with such other currency; if the U.S. Dollars so purchased and remitted are less than the sum originally due to Advisor in U.S. Dollars, the Company agrees, as a separate obligation and notwithstanding any such judgment, to indemnify Advisor against such loss, and if the U.S. Dollars so purchased and remitted exceed the sum originally due to Advisor in U.S. Dollars, the Advisor agrees to remit to the Company such excess.]

17. Governing Law; Miscellaneous. This Agreement shall be governed by, and construed in accordance with, the law of the State of New York. This Agreement sets forth the entire understanding of the parties relating to the subject matter hereof and supersedes and cancels any prior communications, understandings and agreements between the parties relating to the subject matter hereof. This Agreement may not be amended or any terms waived except by a written agreement signed by the parties hereto. This Agreement may not be assigned by the Company or Advisor without the other party's prior written consent. Delivery of an executed counterpart of a signature page to this Agreement by facsimile shall be effective as delivery of an original executed counterpart of this Agreement.

18. Waiver of Jury Trial. Each party hereto irrevocably waives all right to trial by jury in any action, proceeding or counterclaim (whether based on contract, tort or otherwise) arising out of or relating to this Agreement or the transactions contemplated hereby or the actions of the parties hereto in the negotiation, performance or enforcement hereof.

If the Company agrees with the terms of this Agreement, please sign the enclosed copy of this Agreement and return it to _______________, [title], __________________________________ (fax: __________) at or before ___ p.m. (New York City time) on _____________, ____, the time at which this proposal (if not so accepted prior thereto) will expire. If the Company elects to deliver this Agreement by telecopier, please arrange for the executed original to follow by next-day courier.

Sincerely,

[ADVISOR]

By_____________________________
Name:
Title:

Accepted and Agreed
on ___________, 201_:

[NAME OF COMPANY]

By_____________________________
Name:
Title:

SCHEDULE 1

INDEMNIFICATION

The Company shall indemnify and hold harmless Advisor and each of its members, each of their respective affiliates, and each of their respective officers, directors, employees, advisors, agents and representatives (each, an "Indemnified Party") from and against any and all claims, damages, losses, liabilities and expenses (including, without limitation, fees and disbursements of counsel), joint or several, that may be incurred by or asserted or awarded against any Indemnified Party (including, without limitation, in connection with any investigation, litigation or proceeding or the preparation of a defense in connection therewith), in each case arising out of or in connection with or by reason of this Agreement, the Engagement or the transactions contemplated hereby or any actual or proposed use of the proceeds of the Transaction, except to the extent such claim, damage, loss, liability or expense is found in a final, non-appealable judgment by a court of competent jurisdiction to have resulted primarily from such Indemnified Party's gross negligence or willful misconduct. In the case of an investigation, litigation or other proceeding to which the indemnity in this paragraph applies, such indemnity shall be effective whether or not such investigation, litigation or proceeding is brought by the Company, any of its directors, security holders or creditors, an Indemnified Party or any other person, whether or not an Indemnified Party is otherwise a party thereto, and whether or not the transactions contemplated hereby are consummated.

If the foregoing indemnification is unavailable to an Indemnified Party for any reason or insufficient to hold it harmless with respect to any losses, claims, damages, liabilities or expenses referred to therein (in each case, other than as a result of such Indemnified Party's gross negligence or willful misconduct as provided in the immediately preceding paragraph), then in lieu of indemnification the Company shall contribute to the amount paid or payable by such Indemnified Party as a result of such loss, claim, damage, liability or expense in such proportion as is appropriate to reflect the relative benefits received (or anticipated to be received) by each of the parties from the Transaction, or, if such allocation is not permitted by applicable law, then in such proportion as is appropriate to reflect not only the relative benefits received (or anticipated to be received) but also the relative fault of each of the parties in connection with the statements or omissions or actions that resulted in such losses, claims, damages, liabilities or expenses as well as any other relevant equitable considerations. The benefits received (or anticipated to be received) for purposes of the foregoing sentence are acknowledged to be the aggregate amount (without duplication) of the Facilities received in the Transaction (or to be received in the proposed Transaction) in the case of the Company and the compensation paid or to be paid to Advisor under the Engagement in the case of all Indemnified Parties. Relative fault shall be determined by reference to, among other things, whether any losses, claims, damages, liabilities or expenses relate to conduct by the Company or by Advisor (or their respective employees or other agents). The Company and Advisor agree that it would not be just and equitable if contribution were determined by pro rata allocation or by any other method of allocation that does not take into account the equitable considerations referred to above. Notwithstanding the foregoing, the Indemnified Parties' aggregate contribution to the amount paid or payable under this paragraph shall not exceed the aggregate amount of the fees actually received by Advisor under the Engagement.

The indemnity, and reimbursement and contribution obligations of the Company hereunder shall be in addition to any other liability the Company may otherwise have to an Indemnified Party and shall be binding upon and inure to the benefit of any successors, assigns and heirs of the Company and any Indemnified Party.

No Indemnified Party shall have any liability (whether in contract, tort or otherwise) to the Company or any of its security holders or creditors for or in connection with the transactions contemplated hereby, except to the extent such liability is determined in a final non-appealable judgment by a court of competent jurisdiction to have resulted primarily from such Indemnified Party's gross negligence or willful misconduct. In no event, however, shall any Indemnified Party be liable on any theory of liability for any special, indirect, consequential or punitive damages (including, without limitation, any loss of profits, business or anticipated savings).

[SCHEDULE 2

CONFIDENTIALITY

Advisor agrees not to disclose to any person or entity the confidential or proprietary information of the Company furnished to Advisor in connection with the Transaction (the “Company Information”), except (i) to its and its affiliates’ officers, directors, employees, agents, accountants, legal counsel and other representatives (collectively, the “Advisor Representatives”) who have a need to know the Company Information in connection with the Transaction or to properly manage Advisor’s and its affiliates’ banking relationships with the Company and its affiliates and who either (a) agree to be bound by the provisions in this Section applicable to Advisor or (b) owe a duty of trust or confidentiality to Advisor, (ii) in connection with any action or proceeding related to, or the exercise of any remedies under, the Transaction, such banking relationships or this Agreement, (iii) to the extent required by applicable law, regulation, subpoena, court order or other legal process, (iv) to the extent requested by any governmental or regulatory authority having jurisdiction over Advisor or any Advisor Representative, (v) to the rating agencies, (vi) to any actual or potential subordinated investor in any conduit or liquidity provider if such investor or liquidity provider, as the case may be, has signed a confidentiality agreement substantially on the terms of this Section applicable to Advisor, (vii) to dealers and investors in respect of promissory notes of any conduit and credit enhancers in accordance with the customary practices of such conduit for disclosures to dealers, investors or credit enhancers, as the case may be, it being understood that any such disclosure to dealers or investors will not identify the Company or any of its affiliates by name and (viii) to any other person or entity with the Company’s prior written consent. Advisor will be responsible for any failure of any Advisor Representative to comply with the provisions of this Section applicable to Advisor.

Company Information shall not include information that (i) is or becomes publicly available other than through a breach of this Agreement, or (ii) was or becomes available to the receiving party on a non-confidential basis from a source that is not known to such receiving party to be subject to a confidentiality agreement with the Company.

The obligations of the Company and Advisor under this Section shall be in effect from the date of this Agreement until the later of (i) three years from the date of this Agreement, and (ii) if Advisor and the Company enter into the Transaction, the date the Transaction terminates.]

_________________________ (“Lender”)
[Address]

[_______ __, 20__]

Senior Credit Facilities
Commitment Letter

CONFIDENTIAL
Rum & Cola, Inc.
[Address]
Attention: [___________]

Ladies and Gentlemen:

Rum & Cola, Inc. (“Borrower”) has advised Lender who will also act as agent (“Agent”) for a group of lenders, together the “Commitment Parties”; sometimes referred to herein as “we” or “us”) that [it intends to acquire [all of the outstanding capital stock] [all or substantially all of the assets] of Blue Duck Corp. (“Seller”) (the “Transaction”). All references to “Borrower” or “Borrower and its subsidiaries” for any period from and after consummation of the Transaction shall include the Seller.

1. **Commitments.**

The Borrower has requested that Lender commit to provide senior credit facilities in the aggregate amount of up to $_______ (to be comprised of a term loan facility in an aggregate principal amount of $________ and a revolving credit facility in an aggregate principal amount of up to $__________)(collectively, the “Senior Credit Facilities”), and that Lender agrees to arrange and syndicate such Senior Credit Facilities to the Commitment Parties. The proceeds of loans made under the Senior Credit Facilities will be used: (i) [to refinance all of the obligations of the Borrower outstanding]; (ii) to [partially fund the Transaction]; (iii) fund ongoing working capital requirements; (iv) to pay for fees and expenses associated with the Transaction; and (v) for general corporate purposes. The sources and uses of funding for the Transaction are described in the Sources and Uses Table attached hereto as Schedule I.

Based upon and subject to the terms and conditions set forth in this commitment letter (the “Commitment Letter”), the Summary Terms and Conditions attached hereto as Appendix A (the “Term Sheet”) and the fee letter of even date herewith (the “Fee Letter”, and together with the Commitment Letter and the Term Sheet, the “Commitment”), Lender is pleased to advise you of its commitment to provide [the full amount] [up to $________] of the Senior Credit Facilities and to act as the administrative agent and collateral agent in respect thereof, [and to use commercially reasonable efforts to arrange a syndicate of lenders to provide the balance of the necessary commitments for the Senior Credit Facilities]. [It is a condition to Lender’s commitment that the portion of the Senior Credit Facilities not being provided by Lender shall be provided by other lenders]. Lender will act as the sole administrative agent and sole collateral agent and will act as the sole lead arranger and sole bookrunner for the Senior Credit Facilities. You agree that no other agents or arrangers will be appointed, and no other titles or compensation (other than as set forth in the Fee Letter) will be awarded or paid, in connection with the Senior Credit Facilities unless approved by the Commitment Parties.

In consideration of the commitments and agreements of the Commitment Parties hereunder, you agree to pay the nonrefundable fees described in the Term Sheet and the Fee Letter.

2. **Conditions.**

The Commitment does not set forth all of the terms and conditions of the proposed financing; rather, it only summarizes the major points of understanding which will be the basis of the final financing agreements and related documentation (which are collectively referred to herein as the "Loan Documentation") which will be drafted by, and will be in form and substance satisfactory to, the Commitment Parties and their counsel for senior debt financing transactions of this kind. All terms used in this Commitment Letter and not otherwise defined herein shall have the meanings ascribed to them in the Term Sheet.

The Commitment is issued by the Commitment Parties based upon the financial and other information regarding the Borrower and the Transaction previously provided to the Commitment Parties. Accordingly, the Commitment and the structure and terms of the Senior Credit Facilities set forth in the Term Sheet are subject to the fulfillment to the satisfaction of the Commitment Parties of the following conditions (in addition to those set forth in the Term Sheet): (i) there shall not have occurred after [insert date of last audited financial statements] any event, development or circumstance that has had or could reasonably be expected to have a material adverse effect on the business, assets, liabilities (actual or contingent), operations, condition (financial or otherwise) or prospects of the Borrower taken as a whole; (ii) the Commitment Parties shall not become aware of any information or other matter (including new or updated financial information or projections) concerning the [Borrower/Seller] or the Transaction that differs from, or is inconsistent with, the information previously provided to the Commitment Parties by or on behalf of the Borrower in any material respect or that could reasonably be expected to impair syndication of the Senior Credit Facilities, in each case as determined by the Commitment Parties; (iii) the Commitment Parties shall have completed and be satisfied with the results of a business, financial, legal, tax, accounting and environmental due diligence investigation of the [Borrower, the Seller]; (iv) Lender shall have determined that there are no competing issuances of debt, securities or commercial bank facilities of the [Borrower/Seller] or any affiliate thereof, being offered, placed or arranged during or immediately prior to the syndication of the Senior Credit Facilities; and (v) there shall not be any pending or threatened litigation or other proceedings (private or governmental) with respect to any of the transactions contemplated hereby. Further, the Commitment is subject to there not having occurred at any time prior to funding the Senior Credit Facilities any disruption or adverse change in the financial, banking or capital markets that, in the judgment of the Commitment Parties, could impair the syndication of the Senior Credit Facilities.

3. **Syndication.**

We reserve the right, prior to or after the execution of the Loan Documentation, to syndicate all or a portion of the Senior Credit Facilities (including, in our discretion, all or a portion of our commitments hereunder) to a group of financial institutions identified by us in consultation with you. We intend to commence syndication efforts promptly upon the execution of this Commitment Letter, and you agree actively to assist us in completing a satisfactory syndication. Such assistance shall include (a) your using commercially reasonable efforts to ensure that any syndication efforts benefit materially from your existing lending and investment banking relationships and the existing lending and investment banking relationships of the Seller, (b) direct contact between senior management, representatives and advisors of you, the Borrower and the Seller and the proposed Commitment Parties, (c) assistance by you, the Borrower and the Seller in the preparation of a Confidential Information Memorandum for each of the Senior Credit Facilities and other marketing materials to be used in connection with the syndications (the contents of which you will be solely responsible for), (d) [prior to the launch of the syndication, the obtaining of ratings for the Senior Credit Facilities from each of Standard & Poor's Ratings Services ("S&P") and Moody's Investors Service, Inc. ("Moody's")] and (e) the hosting, with Lender, of one or more meetings of prospective Lenders.

Lender will manage all aspects of any syndication, including decisions as to the selection of institutions to be approached and when they will be approached, when their commitments will be accepted, which institutions will participate and any applicable titles, the allocation of the commitments among the Commitment Parties and the amount and distribution of fees among the Commitment Parties. To assist Lender in its syndication efforts, you agree promptly to prepare and provide [(and to use commercially reasonable efforts to cause the Seller to provide)] to Lender all information with respect to the Borrower and the Seller, the Transaction and the other transactions contemplated hereby, including all financial information and projections (the "Projections"), as we may reasonably request. The agreements in this paragraph shall survive termination of this Commitment and the closing of the Senior Credit Facilities.

At our request, you agree to prepare versions of the information package and presentation and other marketing materials to be used in connection with the syndication that do not contain material non-public information concerning Borrower or the Seller, their respective affiliates or their securities. In addition, you agree that unless specifically labeled "Private — Contains Non-Public Information," no information, documentation or other data disseminated to prospective Lenders in connection with the syndication of the Senior Credit Facilities, whether through an internet website (including, without limitation, an IntraLinks workspace), electronically, in presentations at meetings or otherwise, will contain any material non-public information concerning Borrower or the Seller, their respective affiliates or their securities.

4. **Information.**

You hereby represent and covenant that (i) all information, other than Projections, which has been or is hereafter made available to the Commitment Parties by or on behalf of either of the Borrower or Seller or their representatives in connection with the transactions contemplated hereby ("Information") is or, when furnished, will be complete and correct in all material respects and does not and will not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements contained therein not materially misleading in light of the circumstances under which such statements are made, and (ii) the Projections that have been or will be made available to Commitment Parties have been and will be prepared in good faith based upon assumptions that are reasonable at the time made and at the time made available to Lender. You hereby agree to supplement, and to cause the Seller to supplement, the

Information and the Projections from time to time and to promptly advise us of all developments materially affecting Borrower or the Seller, any of their respective affiliates or the transactions contemplated hereby until the closing date of the Senior Credit Facilities so that the representation and warranty in the preceding sentence is correct on the closing date of the Senior Credit Facilities. In structuring and entering into the Senior Credit Facilities, the Commitment Parties will be using and relying on the Information and the Projections without independent verification thereof.

5. **Indemnity and Expenses.**

Borrower agrees (a) to indemnify and hold harmless each Commitment Party and the Lender and their respective affiliates and controlling persons and the respective officers, directors, employees, agents, attorneys, members and successors and assigns of each of the foregoing (each, an "Indemnified Person") from and against any and all losses, claims, damages, liabilities and expenses, joint or several, to which any such Indemnified Person may become subject arising out of or in connection with this Commitment Letter (including the Term Sheet), the Fee Letter, the Transaction, the Senior Credit Facilities or they syndication thereof or any related transaction or any claim, litigation, investigation or proceeding relating to any of the foregoing, regardless of whether any such Indemnified Person is a party thereto, and to reimburse each such Indemnified Person upon demand for any reasonable legal or other expenses incurred in connection with investigating or defending any of the foregoing; *provided* that the foregoing indemnity will not, as to any Indemnified Person, apply to losses, claims, damages, liabilities or related expenses to the extent they are found in a final, non-appealable judgment of a court of competent jurisdiction to have resulted from the willful misconduct or gross negligence of such Indemnified Person, and (b) to reimburse each Indemnified Person from time to time, upon presentation of a summary statement, for all reasonable out-of-pocket expenses (including but not limited to expenses of the Commitment Parties' due diligence investigation, syndication expenses, travel expenses, reasonable fees, disbursements and other charges of counsel to the Commitment Parties), in each case incurred in connection with the Senior Credit Facilities and the preparation of this Commitment Letter, the Fee Letter, the Loan Documentation and any security arrangements in connection therewith and the administration, amendment, modification or waiver thereof (or any proposed amendment, modification or waiver thereof), whether or not the closing date occurs for the Senior Credit Facilities or any Loan Documentation is executed and delivered or any extensions of credit are made under either of the Senior Credit Facilities. Notwithstanding any other provision of this Commitment Letter, no Indemnified Person shall be liable for (i) any damages arising from the use by others of information or other materials obtained through electronic, telecommunications or other information transmission systems, except to the extent such damages are found in a final, non-appealable judgment of a court of competent jurisdiction to have resulted from the willful misconduct or gross negligence of such Indemnified Person or (ii) any indirect, special, punitive or consequential damages in connection with its activities related to the Senior Credit Facilities.

6. **Other Services.**

You acknowledge that the Commitment Parties and their affiliates may be providing debt financing, equity capital or other services (including financial advisory services) to other persons in respect of which you may have conflicting interests regarding the transactions described herein and otherwise. Neither the Commitment Parties nor any of their affiliates will use confidential information obtained from you by virtue of the transactions contemplated by this Commitment Letter or their other relationships with you in connection with the performance by them of services for other persons, and neither the Commitment Parties nor any of their affiliates will furnish any such information to other persons. You also acknowledge that neither the Commitment Parties nor any of their affiliates have any obligation to use in connection with the transactions contemplated by this Commitment Letter, or to furnish to you, confidential information obtained by them from other persons.

You hereby agree that, on or after the closing of the Senior Credit Facilities, Agent or any of its affiliates may place "tombstone" advertisements (which may include any of the Borrower's trade names or corporate logos and a brief description of the Senior Credit Facilities and the Transaction) in publications or other media of their choice (including without limitation "e-tombstones" published or otherwise circulated in electronic form and related hyperlinks to the Borrower's corporate website) at Agent's own expense. In addition, Agent may disclose the information about the Senior Credit Facilities and the Transaction to market data collectors and similar service providers to the financing community.

7. **Confidentiality.**

This Commitment Letter is delivered to you on the understanding that none of this Commitment Letter, the Term Sheet or the Fee Letter nor any of their terms or substance shall be disclosed by you, directly or indirectly, to any other person except (a) to your respective officers, employees, attorneys, accountants and advisors on a confidential and need-to-know basis, and (b) as required by applicable law or compulsory legal process (in which case you agree to inform us promptly thereof) [; provided that you may disclose this Commitment Letter, the Term Sheet and the contents hereof and thereof (but not the Fee Letter or the contents thereof) to the Seller and its attorneys, accountants and advisors on a confidential and need-to-know basis]; provided, however, that such disclosure shall be made only on the condition that such matters may not, except as required by law, be further disclosed. None of this Commitment Letter, the Term Sheet or the Fee Letter nor any of their terms or substance shall be disclosed by the Borrower directly or indirectly to any other potential source of financing without the prior written consent of the Agent. No person, other than the parties hereto, is entitled to rely upon this Commitment Letter or any of its contents or have any beneficial or legal right, remedy, or claim hereunder. No person shall, except as required by law, use the name of, or refer to, Agent, or any of its affiliates, in any correspondence, discussions, press release, advertisement or disclosure made in connection with the Senior Credit Facilities without the prior written consent of Agent.

8. **Survival.**

The compensation, reimbursement, expense, indemnification, confidentiality, governing law, forum and waiver of jury trial provisions contained herein and in the Fee Letter shall remain in full force and effect regardless of whether definitive financing documentation shall be executed and delivered and notwithstanding the termination of this Commitment Letter or Lender's commitment hereunder.

9. **Assignments; Amendments; Governing Law, Etc.**

The Commitment shall not be assignable by you without the prior written consent of the Commitment Parties. The Commitment is intended to be solely for the benefit of the parties hereto and is not intended to confer any benefits upon, or to create any rights in favor of, any person other than the parties hereto (and Indemnified Persons) and you agree that it does not create a fiduciary relationship among the parties hereto. Lender may assign its commitment hereunder to any of its affiliates or any other Commitment Party. Any such assignment to an affiliate will not relieve Lender from any of its obligations hereunder unless and until such affiliate shall have funded the portion of the commitment so assigned. Any assignment to another Commitment Party shall release Lender from the portion of its commitment hereunder so assigned. Any and all obligations of, and services to be provided by, Lender hereunder (including, without limitation, Lender's commitment) may be performed and any and all rights of Lender hereunder may be exercised by or through any of their affiliates or branches. THIS COMMITMENT LETTER SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

EACH OF THE PARTIES HERETO IRREVOCABLY WAIVES THE RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING, CLAIM OR COUNTERCLAIM BROUGHT BY OR ON BEHALF OF ANY PARTY RELATED TO OR ARISING OUT OF THIS COMMITMENT OR THE PERFORMANCE OF SERVICES HEREUNDER.

Each of the parties hereto hereby irrevocably and unconditionally (a) submits, for itself and its property, to the non-exclusive jurisdiction of any New York State court or Federal court of the United States of America sitting in New York City, and any appellate court from any thereof, in any action or proceeding arising out of or relating to this Commitment Letter or the transactions contemplated hereby, or for recognition or enforcement of any judgment, and agrees that all claims in respect of any such action or proceeding may be heard and determined in such New York State or, to the extent permitted by law, in such Federal court, (b) waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or relating to this Commitment Letter or the transactions contemplated hereby in any New York State or in any such Federal court and (c) waives, to the fullest extent permitted by law, the defense of an inconvenient forum to the maintenance of such action or proceeding in any such court.

This Commitment Letter, together with the Term Sheet and the Fee Letter, embodies the entire understanding among the parties hereto relating to the matters discussed herein and therein and supersedes all prior discussions, negotiations, proposals, agreements and understandings, whether oral or written, relating to the subject matter hereof and thereof. No course of prior conduct or dealings between the parties hereto, no usage of trade, and no parole or extrinsic evidence of any nature, shall be used or be relevant to supplement, explain or modify any term used herein. Any modification or waiver of the Commitment or the terms hereof must be in writing, must be stated to be such and must be signed by an authorized representative of each party hereto.

10. **Patriot Act.**

Each of the Commitment Parties hereby notifies you that, pursuant to the requirements of the USA Patriot Act, Title III of Pub. L. 107-56 (signed into law on October 26, 2001) (the "Patriot Act"), it is required to obtain, verify and record information that identifies the Borrower and each Guarantor (as defined in the Term Sheet), which information includes names and addresses and other information that will allow each Commitment Party to identify the Borrower and each Guarantor in accordance with the Patriot Act.

11. **Financing Statements.**

You hereby authorize Agent and its agents to file any and all UCC financing statements (including amendments thereto) deemed advisable by Agent to evidence the granting to Agent (for the benefit of the Commitment Parties) of a security interest in all of Borrower's personal property and assets. In the event the transactions contemplated by this Commitment Letter are not consummated by [_________ __, 20__] and the Borrower has notified Agent that it does not intend to seek financing from the Commitment Parties, then Agent shall terminate all UCC financing statements filed against the Borrower in connection herewith.

12. **Acceptance of Commitment; Termination.**

If you wish to accept the Commitment, please return executed counterparts of this Commitment Letter and the Fee Letter to Lender[, together with a wire transfer to Lender's order in the amount required by the Fee Letter,] on or before 5:00 p.m., New York City time, on [_____ __, 20__]; otherwise, the offer set forth herein shall automatically terminate on such date and time and be of no further force or effect. In the event that the initial borrowing in respect of the Senior Credit Facilities does not occur on or before [_______ __, 20__] or the closing of the Transaction without the use of the Senior Credit Facilities, then this Commitment Letter and Commitment Parties' commitment and undertakings hereunder shall automatically terminate unless the Commitment Parties shall, in their discretion, agree to an extension. Before such date, the Commitment Parties may terminate this Commitment Letter if any event occurs or information becomes available that, in their judgment, results or is likely to result in the failure to satisfy any condition precedent set forth or referred to herein or in the Term Sheet or the other exhibits hereto.

This Commitment Letter may be executed in any number of counterparts, each of which, when so executed, shall be deemed to be an original, but all such counterparts shall together constitute but one and the same agreement. Delivery of an executed counterpart of a signature page of this Commitment Letter by facsimile or electronic transmission shall be effective as a delivery of a manually executed counterpart of this Commitment Letter.

Very truly yours,

LENDER

By:____

Name:

Title:

The Foregoing Is Hereby Accepted And
Agreed To In All Respects By The Undersigned:

RUM & COLA, INC.

By:____

Name:

Title:

APPENDIX A

SUMMARY TERMS AND CONDITIONS

Rum & Cola, Inc.
[Date]

$[ ] Senior Credit Facilities

The Summary Terms and Conditions outlined below is the "Term Sheet" referred to in the Commitment Letter, dated [_____ __, 20__], from Lender to Borrower (the "Commitment Letter"). Terms used in this Term Sheet without definition have the meanings assigned to such terms in the Commitment Letter.

Borrower:	Rum & Cola, Inc. (the "Borrower"). The ultimate structure, including, without limitation, those persons to be "Borrower" and "Guarantors" under the Credit Facilities, will be determined upon Lender's review of the deal structure for the Transaction.
Guarantors:	All present and future direct or indirect subsidiaries of Borrower that are not a Borrower. The Senior Credit Facilities will be fully and unconditionally guaranteed on a joint and several basis by all Guarantors, subject to exceptions to be agreed to the extent such guarantees would be prohibited by applicable law or would result in materially adverse tax consequences.
Administrative, Collateral Agent:	Lender ("Agent").
Lenders:	A syndicate of financial institutions (including Lender) to be arranged by the Lender.
Sole Arranger, Sole Bookrunner:	Lender or "Arranger".
Senior Credit Facilities:	Senior secured credit facilities (the "Senior Credit Facilities") in an aggregate principal amount not to exceed $________ consisting of the following: $_________ ____ -year term loan facility; and $_________ ____ -year revolving credit facility.
Closing Date:	The date on which the initial funding of the Senior Credit Facilities occurs (the "Close Date").

TERM LOAN FACILITY

Facility:	Term Loan in an amount not to exceed $________.
Amortization:	Commencing _____ __, 20__, [the Term Loan will be repayable in __ consecutive quarterly principal installments. The annual amortization schedule will be as follows:

Loan Year	Annual Amount
Year 1	$[________]
Year 2	$[________]
Year 3	$[________]
Year 4	$[________]
Year 5	$[________]]

[OR: the Term Loan will amortize in equal quarterly installments in an aggregate annual amount equal to 1% of the original principal amount thereof with the balance payable on the Term Loan Maturity Date].

Interest Rate:	See Schedule A hereto.
Maturity:	The _____ anniversary of the Close Date (the "Term Loan Maturity Date").
Availability:	The Term Loan will be fully drawn on the Close Date. Amounts borrowed and repaid under the Term Loan may not be re-borrowed.
Use of Proceeds:	The Term Loan will be used (subject to the terms and conditions of the Loan Documentation): (i) to refinance all of the obligations of the Seller outstanding under its existing loan facility and to partially fund the acquisition of the Seller; and (ii) to pay for fees and expenses associated with the Transaction.

REVOLVING CREDIT FACILITY

Facility:	$__________ revolving credit facility, including a sub-limit for [swingline advances and] the issuance of letters of credit (amount, terms and conditions to be determined) (the "Revolver").
Interest Rate:	See Schedule A hereto.
Maturity:	The ______ anniversary of the Close Date (the "Revolver Maturity Date").
Availability:	Amounts under the Revolver may be borrowed, repaid and reborrowed from the Close Date until five business days before the

Revolver Maturity Date. [No more than $_______ of advances shall be made under the Revolver on the Close Date.] [The Revolver shall be unfunded on the Close Date.]

Letter of Credit Issuing Bank:

The Agent and/or certain Lenders (each, an "<u>L/C Issuer</u>") shall either issue letters of credit directly or select another banking or financial institution to issue letters of credit as to which L/C Issuer shall issue letter of credit participation or support agreements (such letters of credit and letter of credit participation or support agreements are referred to herein as "<u>L/Cs</u>").

To the extent that the Borrower does not reimburse the L/C Issuer [(or the swingline lender)] for drawings under L/Cs [(or swingline advances)], the lenders under the Revolver shall be unconditionally obligated to fund participations therein on a ratable basis.

Revolver Fees:

An unused line fee at a rate per annum equal to [____]% shall be payable on the daily unutilized portion of the Revolver. Such fee will be payable [monthly] [quarterly] in arrears on the first day of each [month] [quarter] and on the date of termination of the Revolver commitment. The undrawn amount of outstanding L/Cs shall count as utilization of the Revolver for purposes of calculating this fee.

A participation fee shall be payable to the Agent on behalf of each Revolver Lender with respect to such Revolver Lender's participation in the L/Cs at the applicable margin per annum used for determining interest payable in respect of LIBOR loans made under the Revolver on the average daily undrawn amount of L/Cs, payable [quarterly] in arrears. The Borrower shall also be responsible for paying any fees, costs or expenses (including fronting fees) due to any banking or financial institution (other than the Agent) for any L/Cs issued by such other banking or financial institution in reliance on credit support furnished by the Agent.

The other fees are set forth in the Fee Letter.

Use of Proceeds:

The Revolver will be used (subject to the terms and conditions of the Loan Documentation): (i) to fund ongoing working capital requirements; and (ii) for general corporate purposes.

CERTAIN PAYMENT TERMS

Optional Prepayment:

The Borrower may prepay principal amounts outstanding under the Term Loan and the Revolver, and may terminate commitments under the Revolver, from time to time without premium or penalty [(except as described below)] (except that LIBOR-based loans may only be prepaid at the end of the applicable interest period, unless the Borrower pays all breakage costs associated with such prepayment), subject to applicable minimum amounts to be mutually agreed upon.

[A prepayment fee will be assessed on the principal amount of optional prepayments of the Term Loan [and terminations of commitments under the Revolver] as follows: __% if made on or prior to the first anniversary of the Close Date, __% if made after the first anniversary of the Close Date but on or prior to the second anniversary of the Close Date, and __% if made after the second anniversary of the Close Date but on or prior to the third anniversary of the Close Date.]

Mandatory Prepayment:

In addition to the scheduled amortization payments of the Term Loan, Borrower will be required to make mandatory prepayments in respect of the Term Loan [and to permanently reduce the Revolver commitments] in an amount equal to (in each case, subject to such exceptions to be mutually agreed upon):

- 100% of the net cash proceeds (to be defined) from any sale or other disposition of assets of the Borrower or its subsidiaries (subject to certain exceptions to be determined) other than net cash proceeds of sales or other dispositions of inventory, and other assets in the ordinary course of business and net cash proceeds up to an amount to be determined that are reinvested in other assets useful in the business of the Borrower and its subsidiaries within [180 days][a period of days to be agreed upon] of their receipt upon terms and conditions to be mutually agreed upon;

- [100]% of the net cash proceeds from the issuance of any equity securities by the Borrower or any subsidiaries of the Borrower;

- 100% of the net cash proceeds from the incurrence of indebtedness by the Borrower or any of its subsidiaries (other than indebtedness otherwise permitted by the Loan Documentation); and

- 100% of the net cash proceeds from insurance paid on account of any loss of any property or assets of the Borrower or its subsidiaries in excess of an amount to be agreed (other than net cash proceeds that are reinvested, or that the Borrower has entered into a binding contract to reinvest, in the business of the Borrower and its subsidiaries (or used to replace damaged or destroyed assets) within [180 days][a period of days to be agreed]) of receipt thereof.

- 100% of extraordinary receipts to include purchase price adjustments, indemnity payments, tax refunds, judgments and litigation settlements, and pension plan reversions.

The Borrower will also be required to make mandatory prepayments in respect of the Term Loan in an amount equal to ___% of "Excess Cash Flow" (defined below) of the Borrower and its subsidiaries for each fiscal year (commencing with the fiscal year ending December 31, 20__)[, provided that the foregoing percentage shall be reduced to ___% upon achievement of leverage based performance targets to be agreed].

"Excess Cash Flow" means, with respect to any fiscal year, the excess of earnings before interest, taxes, depreciation and amortization ("EBITDA") as adjusted in a manner to be determined (as so adjusted "Adjusted EBITDA"), for such fiscal year (a) minus the sum of the amounts for such fiscal year of : (i) all applicable taxes paid in cash; (ii) permitted capital expenditures, which are not financed by debt or equity; (iii) cash payments of permitted Debt Service and optional prepayments of the Term Loan(s); (iv) permanent prepayments of the Revolver with a corresponding commitment reduction; and (v) cash payments of management fees not to exceed [$ ______] paid to ____________ to the extent payment thereof is permitted under the Loan Documentation; and (b) plus or minus (as applicable) changes in working capital accounts. Adjusted EBITDA will be determined for any fiscal year by adding back thereto: (i) any amount deducted in calculating net income for such fiscal year which was paid, incurred or accrued in violation of any of the terms of the Loan Documentation and (ii) any other deductions to be mutually agreed upon.

"Debt Service" means all scheduled principal payments (including the principal component of all capital lease obligations) plus all cash interest expense, as determined in accordance with U.S. generally accepted accounting principles ("GAAP").

Application of Prepayments:

All prepayments, whether optional or mandatory, shall be applied first to the Term Loan [on a pro rata basis] [in inverse order of maturity] and second to permanently reduce the Revolver commitments. [The Revolver shall be prepaid and the L/Cs shall be cash collateralized to the extent extensions of credit then outstanding under the Revolver exceed the amount of the Revolver commitments (as reduced).]

<u>COLLATERAL</u>

The Senior Credit Facilities (including any obligations under hedging arrangements provided by the Lenders) will be secured by a perfected first priority security interest in all assets (both real, mixed and personal property), in each case, whether now owned or hereafter acquired, including, without limitation, all receivables, accounts, inventory, general intangibles (including payment intangibles), property, plant and equipment, fee owned and leased real property and patents and other intellectual properties of Borrower and Borrower's present and future subsidiaries whether now owned or hereafter acquired, and all proceeds and products of any of the foregoing (including insurance proceeds). The Senior Credit Facilities will also be collateralized by a perfected first priority pledge of (i) 100% of the issued and outstanding capital stock or other equity interests of the Borrower and the Borrower's direct or indirect domestic subsidiaries [and (ii) 65% of the issued and outstanding capital stock or other equity interests of the Borrower's direct and indirect first-tier foreign subsidiaries, in each case, whether now owned or hereafter acquired, and a pledge of all intercompany indebtedness and, in all cases, all proceeds and products thereof. Without limiting the foregoing, Borrower shall deliver landlord consents and waivers customary in a senior financing wherein the landlord waives any security interest in the collateral, grants Agent and its assignees reasonable access to the leased premises, and consents to the future change of control of the tenant, in the event Agent forecloses on the equity pledge, to the extent such consent is required pursuant to the terms of the lease, [which requirement may be waived by Agent on a property-by-property basis to the extent the cost of procuring such consent and waiver is excessive in relation to the benefits derived from the same.]] [Without limiting the foregoing, Borrower shall deliver leasehold mortgages on all of Borrower's leased premises, which shall be accompanied by, if applicable, subordination, non-disturbance and attornment agreements from Borrower's landlord's lenders and/or landlord consent or estoppel letters from Borrower's landlord, in each case in form and substance acceptable to Agent.]

The foregoing security shall ratably secure the Senior Credit Facilities and any permitted interest rate swap or similar hedging arrangements between the Borrower or Guarantors and a Lender or its affiliates under the Senior Credit Facilities.

CERTAIN CONDITIONS

Conditions Precedent:

Closing and the initial funding under the Senior Credit Facilities will be subject to the satisfaction of all conditions precedent deemed necessary or appropriate by Agent and Lenders, including but not limited to:

- Execution and delivery of satisfactory Loan Documentation;

- [After giving effect to the Transaction including any loans to be made on the Close Date, the ratio of the Borrower's total leverage to Adjusted EBITDA for the twelve month period ended no more than [30 days] prior to the Close Date shall not exceed ____x;]

- The Borrower's Adjusted EBITDA for the twelve month period ended no more than [30 days] prior to the Close Date shall equal at least $_________ from planned continuing operations;

- Agent and Lenders shall have received and be satisfied with (i) audited financial statements for the fiscal years ending ______, ______ and _____ for Borrower and its subsidiaries on a consolidated [and (unaudited) consolidating] basis, (ii) unaudited financial statements for each quarterly [and monthly] period ending after December 31, ____ for Borrower and its subsidiaries on a consolidated [and consolidating] basis, (iii) pro forma financial statements for the twelve-month period ending ______ __, 200_ for Borrower and its subsidiaries on a consolidated [and consolidating] basis and (iv) financial projections for the Borrower and its subsidiaries for fiscal years 200_ through 200_ [(prepared on a [monthly] basis after giving effect to the Transaction)];

- The Borrower and its subsidiaries shall have no debt that will survive the closing of the Senior Credit Facilities other than (i) the Senior Credit Facilities and (ii) other scheduled debt, which may include certain capital leases and other customary obligations, existing on the Close Date and reasonably approved by the Agent. The Agent shall have received, in form and substance satisfactory to Agent, pay-off letters relating to existing outstanding indebtedness;

- Agent or its affiliates shall have conducted a field examination of the Borrower's and Seller's assets, liabilities, cash management system, books and records, and the results of such field examination shall be reasonably satisfactory to the Agent in all respects;

- Agent and Lenders shall have received and be satisfied with the Borrower's insurance policies, including endorsements in favor of the Agent with respect thereto;

- Evidence of a valid and perfected first priority security interest in the Collateral, including UCC and other applicable lien search reports;

- Satisfactory completion of all legal and other due diligence, including Agent's receipt and satisfaction with environmental assessment reports;

- [The Transaction shall have been consummated in accordance with the [purchase agreement dated as of _______, 20__, among the Seller and Borrower] [in form and substance satisfactory to the Agent] and no provision of such agreement shall have been waived, amended or supplemented without the consent of the Lenders;]

- Borrower shall have received a minimum cash equity contribution of $_______ for purposes of consummating the Transaction and the capitalization, structure and equity ownership of the Borrower after consummation of the Transaction, including, but not limited to, the constituent documents of Borrower and related investment agreements shall be satisfactory to the Agent and the Lenders [all preferred equity securities will have a maturity date at least six months after the latest maturity date of the Senior Credit Facilities;]

- All governmental and third party approvals necessary in connection with the Transaction shall have been obtained and be in full force and effect, and all waiting periods shall have expired without any action being taken or threatened by any authority that would restrain or otherwise impose adverse conditions on the Transaction;

- Agent and Lenders shall have received all fees, costs and expenses payable on or prior to the Close Date;

- Agent shall be satisfied that there has been no event, development or circumstance that has had or could reasonably be expected to have a material adverse effect on the business, assets, liabilities (actual or contingent), operations, condition (financial or otherwise) or prospects of the Borrower and/or its subsidiaries, or Seller and/or its subsidiaries since the last audited financial statements submitted to the Agent;

- Agent shall have received such legal opinions, officer solvency certificates and other documents and instruments as are customary for transactions of this type or as it may reasonably request;

- Receipt of all documentation and other information required by bank regulatory authorities under applicable "know your customer" and anti-money laundering rules and regulations, including without limitation the PATRIOT Act and OFAC;

- Agent and Lenders shall have received and approved a breakdown of all uses of proceeds, including fees and expenses [, and fees and expenses relating to the transactions contemplated hereby shall not exceed $________];

- [Agent and each holder of the Borrower's [subordinated][second lien] debt shall have entered into an intercreditor and subordination agreement in form and substance satisfactory to Agent];

- [Agent's receipt and satisfaction with the results of background checks on the Borrower's key management and/or stockholders]; and

- [With respect to each parcel of real estate owned by the Borrower or a Guarantor on which Lenders will have a first priority lien, Agent's receipt of, and satisfaction with, (i) an environmental audit by an environmental engineering firm acceptable to Agent, (ii) title insurance issued by a title insurance company reasonably satisfactory to Agent and (iii) a survey prepared by independent licensed land surveyor reasonably satisfactory to Agent, the costs of all of which shall be paid by the Borrower].

Conditions to Extensions of Credit: The making of each extension of credit (including amendments, extensions and increases of L/Cs) shall be conditioned upon (i) the accuracy in all material respects of all representations and warranties contained in the Loan Documentation (including, without limitations, the material adverse change and litigation representations) and (ii) there being no default or event of default in existence at the time of, or after giving effect to the making of, such extension of credit.

CERTAIN DOCUMENTATION MATTERS

Loan Documentation: The Senior Credit Facilities will be subject to the terms and conditions set forth in a definitive credit agreement, related security agreement(s), guarantees, pledge agreements, mortgages [(including leasehold mortgages)], assignment agreements and other instruments and documents, all of which will be acceptable to the Agent, the Lenders and their legal counsel (collectively, the "Loan Documentation").

Representations and Warranties: The Senior Credit Facilities will contain such representations and warranties by the Borrower as are usual and customary for financings of this kind, including, without limitation, corporate power and authority, due organization and authorization, execution, delivery and enforceability of the Loan Documentation, no default, financial condition and solvency, no material adverse change, title to properties, sufficiency of assets and rights, liens, litigation, payment of taxes, insurance, subsidiaries, business locations, labor matters, material contracts, investment company regulations, brokers' fees, compliance with laws, environmental and ERISA matters, consents and approvals, compliance with anti-terrorism laws, creation and perfection of security interests, [subordination] and full disclosure (subject to qualifications to be agreed).

Reporting: The Borrower will provide the Agent and Lenders with periodic financial reporting, including: audited annual financial statements; unaudited quarterly and monthly financial statements; annual financial projections; compliance certificates; notice of material events and such other information reasonably requested by the Agent or any Lender.

Covenants: The Senior Credit Facilities will contain such affirmative covenants as are usual and customary for financings of this kind, and will likely include, but not be limited to: receipt of timely and accurate financial information; notification of litigation, investigations, environmental and ERISA matters and other material adverse changes; payment and performance of obligations; maintenance of existence; maintenance of property and insurance (including hazard and business interruption coverage); maintenance of accurate records and accounts; visits and inspection of property and books and records; compliance with laws (including, without limitation, environmental laws); compliance with material contractual obligations; maintenance of licenses, permits and franchises issued or granted by any governmental authority; use of proceeds; payment of taxes; ERISA; maintenance of security interests and further assurances (including with respect to security interests in future subsidiaries and after-acquired property); annual lenders meetings; additional grantors and guarantors; separateness of loan parties; post-closing syndication assistance (if applicable); and interest rate hedging requirements.

The Senior Credit Facilities will contain such negative covenants as are usual and customary for financings of this kind, and will likely include, but not be limited to: restrictions and limitations against incurring additional indebtedness and guarantee obligations; encumbrances, liens and other obligations; restrictive payments (including, but not limited to, distributions and dividends, and management, acquisition, arrangement and other similar fees); loans and investments; mergers, consolidations and acquisitions; sale and leaseback transactions; asset transfers and dispositions; changes in business; hedging arrangements; transactions with affiliates; prepayments of and amendments to indebtedness (including, without limitation, prepayment of, and amendments to, any subordinated debt); restrictive agreements; ownership of subsidiaries; bank accounts; amendments to organizational documents; changes in fiscal year or accounting method; negative pledge clauses and clauses restricting subsidiary distributions and changes in the acquisition documentation post-closing that would adversely impact the Lenders.

Financial Covenants: Financial covenants (to be discussed) will likely include, but not be limited to: [minimum EBITDA; minimum fixed charge coverage ratio; minimum interest coverage ratio; maximum leverage ratio; and maximum capital expenditures].

Events of Default: Events of defaults will include those which are customarily found in financing transactions of the type contemplated hereby, including, but not limited to: nonpayment of principal or reimbursement obligations when due; nonpayment of interest, fees or other amounts; inaccuracy of representations and warranties; violation of covenants (subject, in the case of certain affirmative covenants, to a grace period to be agreed upon); cross-default to material indebtedness; bankruptcy events; certain ERISA events; material judgments; actual or asserted invalidity of any guarantee or security document or subordination provisions, if applicable; change of control; and changes in instructions regarding pledged bank accounts.

Cash Management: Borrower shall implement cash management procedures reasonably satisfactory to the Agent and Arranger, including [lock box procedures and] blocked account agreements that will provide for [springing cash dominion following the occurrence of an event of default] [full dominion and automatic daily sweeps into a collection account controlled by the Agent.] [Collections will be credited to the Borrower's loan account one business day following the Agent's receipt of good funds at its bank account in New York, New York (or such other bank account as the Agent may otherwise designate).]

[**Interest Rate Protection:** [Within ninety (90) days following the Close Date, the Borrower shall obtain and, at all times thereafter until the third (3rd) anniversary of the Close Date, the Borrower shall cause to be maintained protection against fluctuations in interest rates pursuant to one or more hedge agreements in form and substance reasonably satisfactory to the Agent, in order to ensure that no less than fifty percent (50%) of the Term Loan at any time outstanding is subject to such hedge agreements.]

Costs and Expenses: The Borrower shall be responsible for the payment (whether or not the transaction contemplated hereby closes or is consummated) of all of Agent's and the Arranger's reasonable costs, fees and expenses of documenting and closing the transaction contemplated hereby (including, without limitation, reasonable costs, fees and expenses of outside legal counsel, travel, lodging and similar expenses) or otherwise paid or incurred by Agent or the Arranger in connection with the Loan Documentation or the transaction contemplated hereby, including, but not limited to, those paid or incurred by Agent or the Arranger in connection with the preparation, negotiation, execution and closing of the Loan Documentation and the transaction contemplated hereby, the arrangement, syndication and administration of the Senior Credit Facilities, the creation or perfection of liens and security interests in connection therewith, and any amendment, modification or waiver in respect of the Loan Documentation. The Borrower shall also be responsible for all fees and expenses of Agent and Lenders incurred or in connection with enforcing rights, remedies and actions taken under the Senior Credit Facilities.

Indemnification: The Borrower shall indemnify and hold harmless Agent, the Arranger and the Lenders, and their respective affiliates and, in each case, such parties' respective directors, officers, employees, agents, representatives and controlling persons (each being an "Indemnified Party") from and against any and all claims, damages, liabilities and expenses (including without limitation, fees and expenses of counsel) that may be incurred by or asserted against such Indemnified Party in connection with the investigation of, preparation for, or defense of any pending or threatened claim or any action or proceeding (whether or not such Indemnified Party is a party thereto) or otherwise arising out of or relating to any of the transactions contemplated hereby, any commitment or similar letter issued in connection therewith, any of the Loan Documentation, any of the transactions contemplated thereby, or any action or omission of any Indemnified Party or other matter or thing under or in connection with any of the foregoing, except for (with respect to any Indemnified Party) any such claims, damages, liabilities or expenses resulting from such Indemnified Party's own gross negligence or willful misconduct as determined by a court of competent jurisdiction in a final nonappealable order or judgment.

Participation and Assignment: The Lenders shall be permitted to assign all or a portion of their loans and commitments with the consent, not to be unreasonably withheld, of (i) the Borrower, unless (x) the assignee is a Lender, an affiliate of a Lender or an approved fund or (y) an event of default has occurred and is continuing, (ii) the Agent, unless a term loan is being assigned to a Lender, an affiliate of a Lender or an approved fund and (iii) the Issuing Bank, unless a term loan is being assigned. Non-pro rata assignments shall be permitted. In the case of partial assignments (other than to another Lender, an affiliate of a Lender or an approved fund), the minimum assignment amount shall be $[   ] in the case of the Term Loan and $[   ] in the case of the Revolver (unless otherwise agreed by the Borrower and the Agent). The Agent shall receive a processing fee of $3,500 in connection with all assignments. The Lenders shall also be permitted to sell participations in their loans.

Required Lenders: Lenders holding at least [51%] [66⅔%] of the loan exposure under the Revolving Facility and Term Loan Facility, in the aggregate (subject to certain customary matters requiring unanimous Lender consent).

Amendments and Waivers:	Subject to approval of Required Lenders party to the relevant Loan Documentation, except that all affected Lenders must consent to increases in commitment amounts, reductions in principal, interest and fees, extensions of maturities and release of substantially all of the guarantors and collateral.
Yield Protection:	The Loan Documentation shall contain customary provisions (i) protecting the Lenders against increased costs or loss of yield resulting from changes in reserve, tax, capital adequacy and other requirements of law and from the imposition of or changes in withholding and other taxes and (ii) indemnifying Lenders for "breakage costs" incurred in connection with, among other things, any prepayment or conversion of LIBOR loans on a day other than the last day of the interest period applicable thereto.
Governing Law and Jurisdiction:	State of New York.
Waiver of Jury Trial:	Such waivers as are customary for financing transactions of the type contemplated hereby.
Administrative Agent's Counsel:	[______________].
Borrower's Counsel:	[______________].

Schedule A

INTEREST RATES

Revolver:

[Prior to delivery of the quarterly compliance certificate for the period ending ____ __, 200_,] Borrower will be required to pay interest on advances outstanding under the Revolver at either: (i) the Prime Rate plus [___]% per annum or (ii) LIBOR Rate plus [___]% per annum.

[Thereafter the applicable interest margins for the Revolver will be adjusted based on the ratio of Total Funded Debt to EBITDA (in each case, to be defined) [in the manner set forth below] [on terms to be determined]:

	Applicable Margin	
Total Funded Debt / EBITDA	**Prime Rate**	**LIBOR Rate**
Greater than or equal to ____x	___%	___%
Less than ___x but greater than ___x	___%	___%
Less than ___x but greater than ___x	___%	___%
Less than or equal to ___x	___%	___%]

Term Loan:

[Prior to delivery of the quarterly compliance certificate for the period ending ____ __, 200_,] Borrower will be required to pay interest on the Term Loan at either: (i) the Prime Rate plus [___]% per annum or (ii) LIBOR Rate plus [___]% per annum.

[Thereafter the applicable interest margins for the Term Loan will be adjusted based on the ratio of Total Funded Debt to EBITDA [in the manner set forth below][on terms to be determined]:

	Applicable Margin	
Total Funded Debt / EBITDA	**Prime Rate**	**LIBOR Rate**
Greater than or equal to ____x	___%	___%
Less than ___x but greater than ___x	___%	___%
Less than ___x but greater than ___x	___%	___%
Less than or equal to ___x	___%	___%]

Prime Rate:

The "Prime Rate" will mean the greater of: (i) the rate of interest per annum quoted in *The Wall Street Journal*, Money Rates Section as the Prime Rate (currently defined as the base rate on corporate loans posted by at least seventy five percent (75%) of the nation's thirty (30) largest banks) in effect from time to time (or if such rate is at any time not available, the prime rate so quoted by any banking institution selected by Agent), which rate is not intended to be the lowest rate charged by any such banking institution to its borrowers or (ii) the Federal Funds Effective Rate per annum plus 0.50%. Interest on Prime Rate loans will be computed and payable [monthly] in arrears on the basis of a 360 day year and based on the actual number of days elapsed.

LIBOR Rate: LIBOR-based loans will be made available, subject to market conditions, for interest periods of one, two, three or six months (as selected by the Borrower). The Borrower may elect to use the LIBOR rate provided (i) the Borrower gives Agent at least three business days prior notice of such election and (ii) no default is then outstanding under the Loan Documentation. Interest on LIBOR-based loans will be computed and payable at the end of the applicable LIBOR interest period (or, in the case of any interest period longer than three months, at the end of each three month period) in arrears on the basis of a 360 day year and based on the actual number of days elapsed.

Default Interest: Upon the occurrence and during the continuance of an Event of Default (upon written notice, except in the case of any bankruptcy, insolvency, reorganization, liquidation or other similar proceeding), amounts outstanding under the Senior Credit Facilities shall bear interest at 2.00% per annum above the rate otherwise applicable thereto and LIBOR-based loans and conversions to LIBOR-based loans shall no longer be available. Overdue interest, fees and other amounts shall accrue interest at 2.00% above the rate applicable to Prime Rate loans.

[Schedule I]

[SOURCES AND USES TABLE]

Sources:	Term Loans	$	
	Revolver Loans	$	
	Common Equity	$	
	Total Sources		$
Uses:	Purchase of [Common Stock] [assets]	$	
	Refinancing of Existing Debt	$	
	Payment of Fees and Expenses	$	
	Total Uses		$

[Lender]
[Address]

_______ __, 20__

Senior Credit Facilities
Fee Letter

CONFIDENTIAL
Rum & Cola, Inc.
[Address]
Attention: [___________]

Ladies and Gentlemen:

This letter is the Fee Letter referred to in that certain Commitment Letter of even date herewith (together with the Term Sheet attached thereto, the "Commitment Letter") from Lender to you, whereby Lender, as agent (the "Agent") for itself and the other lenders, has committed to provide up to $____________ in the aggregate with respect to the senior credit facilities described therein (the "Senior Credit Facilities"), subject to the terms and conditions set forth in the Commitment Letter. This Fee Letter sets forth fees not described in the Commitment Letter and certain other matters. All capitalized terms used in this Fee Letter and not otherwise defined shall have the meanings assigned to such terms in the Commitment Letter.

To induce Lender to execute and deliver the Commitment Letter in its capacities as the Agent and a Lender, you hereby agree to pay the following fees:

(i) a commitment fee in an amount equal to $________ (or, if greater, _____ percent (___%) of the aggregate committed amount of the Senior Credit Facilities), [______ of which amount is payable upon your execution of the Commitment Letter with the remaining amount to be] payable on the Close Date;

[(ii) an upfront fee for the account of each Lender (including Lender) in an amount equal to ___% of the aggregate committed amount of the Senior Credit Facilities, payable on the Close Date;] and

(iii) an annual administrative agent fee [(which shall include a fee for acting as collateral agent)] in the amount of $______, payable in advance on the Close Date and on each anniversary of the Close Date thereafter.

Additionally, to induce Lender to proceed with its consideration of the transaction outlined in the Commitment Letter, please remit a good faith deposit of $[_____] (the "Good Faith Deposit") to cover out-of-pocket expenses incurred by Lender relating to, among other things, due diligence and legal fees. The unused portion of the Good Faith Deposit will be credited against the amount of the commitment fees due on the Close Date in the event the financing transaction contemplated in the Commitment Letter is consummated or returned to you if such financing transaction is not consummated for any reason.

All of the fees payable hereunder or pursuant hereto shall be payable in immediately available funds, shall be deemed fully earned when due and payable and, once paid, shall be non-refundable. Lender may allocate among its affiliates and/or the other Lenders, any of the fees payable to it in this Fee Letter in its sole discretion.

[In addition, Lender (or an affiliate) shall have the right to invest no less than $[________] in the equity of Borrower on the Close Date substantially on the same terms and conditions as shareholders of the Borrower.]

[In addition, in consideration for Lender's services in connection with the Transaction, you hereby agree to offer Lender (or any of its affiliates designated by Lender) the opportunity (which it may accept or decline in its sole discretion) to provide, all interest rate collars, swaps, hedges and other interest rate fixing financial services and foreign currency hedges for Borrower for so long as the Senior Credit Facilities shall be in place and on terms and conditions and pursuant to documentation satisfactory to Lender.]

A portion of the loans under the Senior Credit Facilities will be syndicated to other banks and financial institutions. In addition to the conditions described in the Commitment Letter, the funding of the initial loans under the Senior Credit Facilities will be subject to the condition that Lender has [been afforded a reasonable period of time following launch of the general syndication of the Senior Credit Facilities and prior to the Close Date to complete] [completed] a successful syndication of the Senior Credit Facilities such that Lender holds no more than $________, of which not more than $_____ shall be in respect of the ______ (a "<u>Successful Syndication</u>").

Notwithstanding anything in the Commitment Letter to the contrary, at any time until Lender has achieved a Successful Syndication (whether before or after the execution and delivery of the Loan Documentation), then Lender shall be entitled, after consultation with you, to change the pricing, structure, tranching, collateral package and terms of the Senior Credit Facilities[; <u>provided</u>, <u>however</u>, that [(i) the applicable margins for the Revolver and the Term Loan shall not be increased by more than ___% on a weighted average basis (it being understood that all or a portion of any such increase may take the form of original issue discount ("<u>OID</u>") or upfront fees (which shall be deemed to constitute like amounts of OID), with OID being equated to the interest rates in a manner determined by Lender based on an assumed four-year life to maturity)] [and (ii) the aggregate amount of the Senior Credit Facilities shall remain unchanged]]. [It is further agreed that the changes to the terms of the Senior Credit Facilities permitted by this paragraph may take the form of call protection provisions applicable to the [Term Loan] [Senior Credit Facilities] if repaid with the proceeds of indebtedness or in connection with a repricing amendment, so long as the prepayment premium does not exceed (i) [3]% through the first anniversary of the Close Date, [2]% from the first anniversary of the Close Date through the second anniversary thereof and [1]% from the second anniversary of the Close Date through the third anniversary thereof.] In the event Lender determines to exercise its rights under this paragraph, the Commitment Letter shall be deemed to be amended to reflect such changes, and the syndication process shall continue. In addition, in the event that the Loan Documentation is executed and delivered prior to Lender determining to exercise in full its rights under this paragraph, you agree that you will execute any amendment to such Loan Documentation deemed advisable by Lender and consistent with the limitations set forth herein to effect such changes and that any failure to do so shall be an event of default under the Loan Documentation as though fully set forth therein.

[If, in connection with the consummation of the Transaction, or, in lieu of the Transaction, any similar transaction consummated within the next twelve months from the date hereof, in which you or any of your affiliates acquire, directly or indirectly, all or any substantial portion of the capital stock or assets of the Seller (any such foregoing transaction, an "Alternate Transaction"), another institution proposes to provide any financing in lieu of the Senior Credit Facilities (notwithstanding a willingness on the part of the Agent to provide the Senior Credit Facilities), you agree to provide the Agent a reasonable opportunity to provide such bank or bridge financing on substantially the same terms so proposed prior to the consummation of the Transaction or such Alternate Transaction and to appoint the Lender as sole lead arranger and as sole lead bookrunner for such alternate financing to the extent the Agent has agreed to provide such financing on such proposed terms or such other terms as are mutually agreed between you and the Agent. In the event you do not provide Agent with the opportunity to provide such financing, then you agree to pay to Lender at the time of consummation of the Transaction or Alternate Transaction an amount equal to the commitment fee described in clause (i) above.] [You also agree that if you enter into a definitive agreement in connection with the Transaction or any Alternate Transaction that provides for the payment of a so-called "topping fee," "break-up fee," or any similar termination fee or the payment or any other form of consideration (including reimbursement of expenses) in the event that the Transaction or such Alternate Transaction is not consummated, you agree to pay to Lender, in immediately available funds, upon receipt by you of such fees or other consideration, a fee equal to the lesser of (i) the respective commitment fee described in clause (i) above and (ii) 25% of such "topping fees," "break-up fees," other termination fees or other forms of consideration (including reimbursement of expenses) received by you (after reimbursement of your expenses).]

You hereby agree to keep this Fee Letter and its contents strictly confidential in accordance with the confidentiality provisions set forth in the Commitment Letter.

This Fee Letter may be executed in counterparts which, when taken together, shall constitute one and the same document. Delivery of an executed counterpart of a signature page of this Fee Letter by facsimile or electronic transmission shall be effective as delivery of a manually executed counterpart of this Fee Letter. This Fee Letter, together with the Commitment Letter, embodies the entire agreement and understanding among Lender and you with respect to the specific matters set forth above and supersedes all prior agreements and understandings relating to the subject matter hereof. This Fee Letter may not be amended or any provision hereof waived or modified except by an instrument in writing signed by Lender and you. No party has been authorized by Lender to make any oral or written statements inconsistent with this letter.

It is understood and agreed that this Fee Letter shall not constitute or give rise to any obligation to provide any financing; such an obligation will arise only under the Commitment Letter if accepted in accordance with its terms. **This Fee Letter shall be governed by, and construed in accordance with, the laws of the State of New York without regard to principles of conflicts of law to the extent that the application of the laws of another jurisdiction would be required thereby.** Any right to trial by jury with respect to any claim or action arising out of this Fee Letter or conduct in connection with this agreement is hereby waived. The provisions of this Fee Letter shall survive the expiration or termination of the Commitment Letter (including any extensions thereof).

This Fee Letter may not be assigned by you without the prior written consent of Lender.

The undertakings and commitments of Lender as set forth in the Commitment Letter are subject to your acceptance of the Fee Letter and the Commitment Letter in the manner provided in the Commitment Letter.

Very truly yours,

[LENDER]

By:_______________________________________
Name:
Title:

Accepted and Agreed to in all respects:

Rum & Cola, Inc.

By:_______________________________________
Name:
Title:

DUE DILIGENCE CHECKLIST

	Item	Responsibility	Status
A.	**Financial statements and related matters:**		
1.	Three years' audited consolidated financial statements for the Company and any unconsolidated subsidiaries and (if available) unaudited consolidating statements, with access to auditors' work papers		
2.	Unaudited financial statements for the Company and any unconsolidated subsidiaries for all quarterly and (if available) monthly periods subsequent to the most recent period covered in A.1 above, with comparable statements for the prior fiscal year		
3.	Auditors' letters to management for the last three years		
4.	Auditors' inquiry letters and replies for the last three years		
5.	Pricing policies and compliance		
6.	Any reports to the Board of Directors reflecting upon internal corporate controls		
7.	List of accounts receivable and quality, aging, etc.		
8.	List of material assets, including machinery and equipment, office furniture, fixtures and inventory with locations specified; report on physical inventory		
B.	**Tax matters:**		
1.	Copies of tax returns for latest closed and all open years for the Company and its subsidiaries, audit and revenue agents' reports, settlement documents and correspondence for last three years, agreements waiving statute of limitations or extending time, tax sharing arrangements and tax indemnity agreements to which the Company or any of its subsidiaries is a party and copies of accountants' due diligence reports, including without limitation, fair market value and asset bases of assets of Company and its subsidiaries, including the respective basis of each parent corporation in the stock of its subsidiaries		

	Item	Responsibility	Status
C.	**Employees, benefit plans and labor matters:**		
1.	Employee census data – number of total employees, union and non-union employees, distribution of employees, turnover and absentee history		
2.	Union and collective bargaining agreements		
3.	Management, employment and consulting agreements; agreements relating to severance or change of control; confidentiality agreements		
4..	Qualified pension, retirement, savings and profit-sharing plans		
5.	Health, life, disability, accident and other welfare benefit plans		
6.	Non-qualified retirement, bonus, incentive and deferred compensation plans or programs		
7.	Trust or other funding agreements, including insurance contracts, service provider agreements and agreements with investment managers, for benefit plans		
8.	Most recent Forms 5500 (or the equivalent thereof), including schedules, and actuarial reports		
9.	Most recent accountings for benefit plans funded through a trust		
10.	For each defined benefit plan, a statement of plan assets and liabilities based on plan assumptions and assumptions prescribed by the Pension Benefit Guaranty Corporation		
11.	Estimate of potential withdrawal liability from each multi-employer plan		
12.	Most recent IRS determination letter for each qualified plan		
13.	Notices of intent to terminate and notices of reportable events with respect to defined benefit plans; notices from the Pension Benefit Guaranty Corporation with respect to the termination of a defined benefit plan		

	Item	Responsibility	Status
14.	Notices, filings and other documentation with respect to any withdrawals from defined benefit plans, including multiemployer plans		
15.	Severance and separation, fringe benefit and perquisite, holiday, vacation, leave of absence, layoff, day or dependent care, legal services and cafeteria plans and policies		
16.	Summary plan descriptions, sample summary annual reports, sample health care continuation notices required under COBRA and other materials required to be furnished to employees with respect to benefit plans		
17.	All qualified domestic relations orders and orders governing payments from any benefit plan		
18.	Personnel policy handbooks, brochures and other employee literature		
19.	Summaries of labor disputes, strikes, work stoppages, organizational efforts or other union action or concerted action by employees within the last five years, grievance proceedings, arbitrations or requests for arbitration or NLRB or EEOC charges or complaints		
20.	List of dates of all OSHA or similar state regulatory authority inspections within last five years, including copies and a complete description of all citations or related charges; records of all occupational injuries and illnesses for past five years and any related employee complaints; copies of all documents filed with OSHA or similar state agency in past five years; correspondence with or from OSHA or similar state agency		
21.	Any document relating to hazardous work conditions		
22.	Is the Company or any of its subsidiaries a government contractor or sub-contractor subject to Executive Order 11246, the Rehabilitation Act of 1973 or the Vietnam Veterans Era Readjustment Assistance Act of 1974? If so, determine whether appropriate affirmative action program in place, whether Company/subsidiary has ever been declared non-compliant, EEO-1 reports		

	Item	Responsibility	Status
23.	Management organizational chart		
D.	**Insurance of the Company and its subsidiaries:**		
1.	D&O insurance		
2.	All insurance contracts		
3.	Key man insurance		
4.	Workers' compensation		
5.	Notices from carriers denying liability or coverage or asserting reservation of rights under existing policies		
6.	Summary of experience in self-insurance programs		
E.	**Intellectual property of the Company and its subsidiaries:**		
1.	List of computer programs (including all source codes) and related documentation		
2.	List of common-law protective measures with respect to service marks, service names, trademarks, trade names, patents, copyrights, trade dress, business and product names, logos and slogans		
3.	Registrations and applications for any of the foregoing		
4.	Copies and a list of all grants, registrations, assignments and licenses of patents, trademarks, trade names, copyrights, service marks, service names and other intellectual property rights, indicating when and where such rights became effective		
5.	Copies of forms of agreements with employees covering development of intellectual property, together with list of employees covered thereby		
F.	**Properties of the Company and its subsidiaries:**		
1.	Deeds, mortgages, deeds of trust, title insurance policies, title reports, surveys, certificates of occupancy and appraisals and valuations		

	Item	Responsibility	Status
2.	Leases and subleases (as lessor or lessee) and renewal letters		
3.	Information with respect to energy sources and cost		
4.	Description of encumbrances and zoning restrictions		
5.	List of government-owned equipment		
G.	**Licenses/Permits:**		
1.	Material license agreements running to and from the Company or a subsidiary (including environmental licenses)		
2.	Material permits or government consents running to the Company or a subsidiary (including environmental permits)		
H.	**Other contracts and arrangements (whether written or oral (in which case, reasonable summaries thereof) including all amendments and waivers) of the Company and its subsidiaries:**		
1.	Evidence of material indebtedness (in excess of $1MM)		
2.	Non-compete agreements or agreements restricting lines of business		
3.	Sale and leaseback arrangements		
4.	Powers of attorney and similar delegations of authority		
5.	Material contracts, including transportation agreements with common carriers		
6.	Brokers' or finders' agreements		
I.	**Litigation and Regulatory Matters:**		
1.	Litigation list together with attorneys' audit letter responses		
2.	List of governmental and administrative proceedings and investigations		
3.	Consent decrees and injunctions, judgments, orders, settlement agreements, etc.		

	Item	Responsibility	Status
4.	All reports, notices, correspondence, filings or other related documents with federal, state, local or foreign governmental agencies during the preceding five years which relate to the Company, its subsidiaries, properties or business		

OMNIBUS PLEDGE AND SECURITY AGREEMENT QUESTIONNAIRE

The undersigned ("Obligor") is entering into an Omnibus Pledge and Security Agreement. In connection with the Omnibus Pledge and Security Agreement, Obligor is required to answer the following questions.

1. Is Obligor a registered organization? If so, provide its exact name as it appears on its registration document, its state of registration, its organizational ID if provided by such state, its tax ID number, and the type of entity (e.g., corporation, limited partnership, etc.). If not, provide the type of entity (e.g., trust, individual, etc.), its full legal name and tax ID number or social security number.

   ____

   ____

   ____

2. Has Obligor ever changed its name? If so, state each other name Obligor has had and the date of each change.

   ____

   ____

   ____

3. Does Obligor do business under any other name? If so, state each such name.

   ____

   ____

   ____

4. Does Obligor use or has Obligor used any trade names or trade styles? If so, list each of them.

   ____

   ____

   ____

5. Has Obligor changed its identity or corporate structure in any way within the past four months? Changes in corporate structure would include incorporation of a partnership or sole proprietorship, mergers, consolidations and acquisitions. If any such change has taken place, indicate the nature of such change and give the names of each corporation or

other entity that was incorporated, merged or consolidated with or acquired by Obligor in such transaction (including each name under which each such corporation or entity has done business) and the address of each place of business of each such corporation or entity immediately prior to such incorporation, merger, consolidation or acquisition and within four months prior to the date of this questionnaire.

____

____

____

6. State the complete address (including the county) of Obligor's chief executive office and, if an individual, such individual's principal residence and, if different from its chief executive office, of the office where Obligor keeps its books and records relating to its accounts or contract rights.

____

____

____

7. Has Obligor's chief executive office or office where Obligor keeps its books and records relating to its accounts or contract rights been located at any other address during the past four months? If so, specify each such address (including the county).

____

____

____

8. State the complete address (including the county) of each other place of business that Obligor presently has.

____

____

____

9. State the complete address (including the county) of each place of business that Obligor has had in the past four months, other than those listed in the answers to questions 6, 7 and 8.

____

____

____

10. State the complete address (including the county) of each location where Obligor keeps any inventory or equipment, other than the places of business listed in the answers to questions 6, 7 and 8.

____

____

____

11. Has any of Obligor's inventory or equipment been located during the past four months at any location other than the locations listed in the answers to questions 6, 7, 8, 9 and 10? If so, state the complete address (including the county) of each such location.

____

____

____

12. Does any person or entity other than Obligor have possession of any of Obligor's inventory or equipment (for example, on rental from Obligor)? If so, state the name and address (including the county) of each such person or entity.

____

____

____

13. When Obligor purchases goods, are there any places in which such goods might in the usual course of the purchase transaction be located, even temporarily for purposes of transshipment? If so, state the complete address (including the county) of each such location.

____

____

____

14. Has Obligor acquired any of its inventory or equipment other than in the ordinary course of business? If so, specify the items and the nature of any such acquisition.

____

____

____

15. Does Obligor own or have an interest in any goods other than inventory or equipment, such as crops, minerals or the like? If so, please describe such goods and state the complete address (including the county) where such goods are located.

____

____

____

16. Are any of Obligor’s accounts receivable payable by the United States Government, a state or local government, or any department or agency thereof? If so, please state the aggregate amount thereof, the identity of the obligor and the percentage that those accounts receivable are of all of Obligor’s accounts receivable, in each case, as of a recent, specified date.

____

____

____

17. (a) Please supply the following information with respect to each patent and patent application in which Obligor has any interest (whether as owner, licensee or otherwise):

Patents

Nature of Interest (e.g., owner, licensee)	Registered Patent No.	Issue Date	Country of Issue

Patent Applications

Nature of Interest (e.g., owner, licensee)	Serial Number	Filing Date	Country of Application

(b) If Obligor's interest in any of the foregoing is otherwise than as owner, please describe the nature of such interest.

____

____

____

18. (a) Please supply the following information with respect to each registered trademark and trademark application in which Obligor has any interest (whether as owner, licensee or otherwise).

Registered Trademarks

Nature of Interest (e.g., owner, licensee	Registered Trademark	Regis-tration Number	Property Covered	Date Registered	Docket Number	Country of Registration

Trademark Applications

Nature of Interest (e.g., owner, licensee	Trademark Application relates to following Trademark	Serial Number	Property Covered	County of Application

(b) If Obligor's interest in any of the foregoing is otherwise than as owner, please describe the nature of such interest.

____

____

____

Obligor hereby certifies that its answers to the foregoing questions are complete and correct and confirms that such answers constitute representations and warranties under the Omnibus Pledge and Security Agreement.

Dated: New York, New York
_____________, 20__

[OBLIGOR]

By: ___________________________

Title: _________________________

Address of Obligor:

____

____

Global List of Preferred Title Comments/Endorsements

This list should be tailored to the specific deal *before* it is sent to the title company.

The following is a list of our title requirements to the extent such coverage is available in the state and applicable to the transaction.

I. General

1. The form policy to be issued shall be the 1992 ALTA Lender's policy form, with the Creditor's Rights exclusion deleted by endorsement, or alternatively, the 1970 revised 1984 ALTA Lender's policy form.

2. The effective date of the policy shall reflect the following language:

   Dated: [Closing Date]_, 20__, to be redated the date of recording of the insured instrument.

3. The insured shall be "______________________, its successors and/or assigns".

4. Title to the land on the effective date of the policy shall be vested in **[***entity name of Borrower***]**.

5. Add all beneficial items identified in reciprocal easement agreements as insured items on Schedule A.

II. Exceptions

1. Omit all general exceptions.

2. All exceptions for taxes should state that such taxes are "*not yet due and payable*".

3. To the extent possible, all easements listed as exceptions in the Policy should be referenced to the survey by including the following language: "*as shown on that certain survey dated ______, prepared by __________*" which shall refer to the survey being delivered to Lender in connection with the Loan.

4. Exceptions for rights of tenants (or parties in possession) should be moved to a subordinate matters schedule (Schedule B-II) as we anticipate that all of the leases (if any) are automatically subordinate or we will be getting an SNDA. The exception in the subordinate matters schedule (Schedule B-II) should read "*rights of tenants as tenants only under unrecorded, unexpired leases with no right or option to purchase*".

III. Affirmative Insurance

Note: Any REA should include Inserts A and B.

Insert A

For Easements which are Excepted:

Title company hereby insures the owner of the indebtedness secured by the mortgage referred to in Paragraph __ of Schedule A against loss resulting from the following:

1. Damage to the existing improvements, including lawns, shrubbery and trees, on the land;

2. Interference with the continuing use, as presently utilized, of the existing improvements on the land, occasioned by the exercise of the right to use or maintain the easement

(or 103.1 endorsement)

Insert B

For items containing CC&Rs which are Excepted:

Policy affirmatively insures the Insured that (i) there are no violations of the covenants and restrictions therein contained and that a future violation will not result in a forfeiture or reversion of title and (ii) that there is no condition or right of re-entry under which the insured mortgage can be cut off, subordinated or otherwise disturbed in whole or in part.

(or modified 5.1 endorsement (or FA 18 endorsement))

Insert C

For survey reading Exception:

Policy affirmatively insures against monetary loss by reason of any of the above mentioned projections, encroachments or variations.

IV. Subordinate Matters: Schedule B-II: Add a Schedule B-II, which shall include the following:

1. Assignment of Leases and Rents made by [Borrower] in favor of __________________, dated _______________, 20___ and recorded in ___________________.

2. (As noted in "Exceptions", above) Rights of tenants in possession, as tenants only under written, unrecorded and unexpired leases with no option to purchase.

V. **Endorsements**: The following is a list of endorsements to be included in the policy, if available (the preferred forms of endorsement, if any, are listed):[1]

1. ALTA 9 Comprehensive
2. Same as Survey (116.1)
3. Access to Public Ways (103.7)
4. Environmental/EPA Lien (110.9)
5. Tax Parcel (ALTA 18 or 18.1, as applicable)
6. Public Street (103.7)
7. Waiver of Arbitration
8. Usury
9. Truth in Lending (125 or ALTA 2)
10. Assignment of Rents/Leases (104.6)
11. Doing Business
12. Zoning (with parking) Endorsement (3.1)[2]
13. Creditor Rights Exclusion (if ALTA 1992 policy is used)
14. Mechanic's Liens (101) (*if applicable*)
15. Right to use/maintain easements (*if applicable*)[3]
16. Subdivision (116.7) (*if applicable*)
17. Contiguity (116.4) (*if applicable*)[4]
18. Me-Too (from each co-insurer) (*if applicable*)[5]
19. Leasehold Improvements (107.5) (*only for **Ground Lease** transactions*)[6]

---

[1] Please make an effort to tailor the endorsements requested to match the transaction and the availability of endorsements in the state in which the property is located. To check endorsement availability go to: http://www.ntiweb.com/default.aspx. Login name: jbionda. Password: mimib. Click on "Select States" (middle of page). Check applicable state(s). Once updated, under Forms/ Endorsements (left hand side) click on: both "State Specific" (non-ALTA or CLTA forms available in the state) and "Availability" (ALTA or CLTA endorsements available in the state)

[2] (**The zoning endorsement with parking is very important - please let us know immediately if there will be any difficulty in obtaining a zoning endorsement or if such endorsement is not available**)

[3] Obtain this endorsement if title company is unable to include beneficial easements to the insured legal description.

[4] For properties which are comprised of more than one parcel.

[5] Co-insurance or re-insurance is required on loans over $50,000,000.

20. Future Advance (ALTA 14.1) (*only for transactions with **future advances***)[7]

21. Variable Rate (111.6) (*only for **floating rate** loans*).

For Multi-Property Deals

1. First Loss
2. Last Dollar
3. Tie-In[8]

Please provide a list of availability and prices for the above endorsements as soon as possible.

[The foregoing are our preliminary title requirements, which remain subject to receipt and review of the title commitment and underlying documents. Additionally, please note that additional endorsements may be requested upon review of the Commitment.][9]

[A mark-up of the Commitment is attached hereto.]

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6 This endorsement provides that the value of the lessee's interest in improvements, even though cast as "personal property" in the insured lease, will be included as an element of loss otherwise insured against under the leasehold policy.

7 Make sure to get ALTA 14.1 (rather than 14), since this includes coverage even after insured has knowledge of an intervening lien, encumbrance or other matter affecting title.

8 Note that if any of the properties in a multi-property deal are in states where a tie-in endorsement is not available (i.e., NY, FL), the policy amount for the non-tie-in-able properties should be grossed up to an amount equal to either (i) 150% of the allocated loan amount for such property or (ii) 125% of the appraised value of such property (this is to comply with S&P requirements – if there is any objection, the gross up should be no less than 125% of the allocated loan amount for the un-tie-in-able property). Note that some states (i.e., FL, TX) which can't tie-in to other policies for properties out of the state can tie-in to same state properties (i.e., if there is more than one FL property, the FL properties can tie-in to each other. Same with TX (see special TX tie-in endorsement below)).

9 If sent out before commitment is received.

**DUE DILIGENCE CHECKLIST
FOR ENVIRONMENTAL DISCLOSURE**

Documents relating to Solid Waste Management.

1. Copies of all environmental applications, permits, plans, registrations or approvals relating to solid waste management.

2. Copies of any waste determinations and analyses (such as analyses used to classify wastes).

3. Copies of all landfill operations reports.

4. Copies of all agency inspection reports and related correspondence regarding solid waste management.

5. Copies of all notices of violation regarding solid waste management and related correspondence or other documents.

Documents relating to Site Sampling or Testing.

6. Copies of all groundwater monitoring results.

7. Copies of all soil boring data or soil sampling results.

Documents relating to Hazardous Waste Management.

8. Copies of all environmental applications, permits, plans, registrations or approvals relating to hazardous waste management.

9. Copies of all hazardous waste handling or storage records.

10. Copies of all hazardous waste shipment or disposal records, including hazardous waste manifests.

11. Copies of all agency inspection reports and related correspondence regarding hazardous waste management.

12. Copies of all notices of violation regarding hazardous waste management and related correspondence or other documents.

Documents relating to Air Emissions.

13. Copies of all environmental applications, permits, plans, registrations or approvals relating to air emissions.

14. Copies of any air emission inventories and Air Information Management System (AIMS) reports.

15. Copies of all agency inspection reports and related correspondence regarding air emissions.

16. Copies of all notices of violation regarding air emissions and related correspondence or other documents.

Documents relating to Water Discharges.

17. Copies of all environmental applications, permits, plans, registrations or approvals relating to water discharges.

18. Copies of all agency inspection reports and related correspondence regarding water discharges.

19. Copies of all notices of violation regarding water discharges and related correspondence or other documents.

Documents relating to Storage Tanks.

20. Copies of all environmental applications, permits, plans, registrations or approvals relating to underground or aboveground storage tanks.

21. Copies of all agency inspection reports and related correspondence regarding underground or aboveground storage tanks.

22. Copies of all notices of violation regarding underground or aboveground storage tanks and related correspondence or other documents.

23. Copies of all reports of removal or closure of underground or aboveground storage tanks.

Documents relating to Occupational Health and Safety.

24 Copies of all industrial hygiene or occupational safety reports.

25. Copies of all agency inspection reports and related correspondence regarding worker health and safety.

26. Copies of all notices of violation regarding worker health and safety and relating correspondence or other documents.

Site Assessment or Audit Documents.

27. Copies of all reports of prior environmental assessments and audits.

28. Copies of all reports of environmental site surveys (e.g., wetlands delineations).

Documents relating to Environmental Cleanup Liabilities.

29. Copies of any information requests under CERCLA Section 104(e) or any state law equivalent, and responses thereto.

30. Copies of any notification of potential liability at any site under CERCLA or any state law equivalent.

31. Copies of any notifications of claims of liability relating to environmental cleanup.

32. A listing of all firms used for transport or disposal of any waste material (hazardous or non-hazardous), including:

a. Time period used.

b. Type of waste handled.

c. Disposal or processing location.

Documents relating to Asbestos or PCBs.

33. Copies of asbestos surveys or documents relating to asbestos removal.

Forces at Play - Relative Leverage of the Parties

The MAC Clause - Definition

- MAC clause traces back to 19th Century British Bond Indentures
- Material adverse effect/change on seller/target's business, condition, results of operations
- Allocates risk of deterioration of seller/target's business between sign and close
- "prospects" and "could/would" result in a MAC
- Tension between knowing when a MAC occurs versus failure to reach a deal
- Generally allocate market risk to buyer and adverse events that effect Seller to Seller (the Seller bears the risk it can affect and not the risk that it cannot)

MAC Clause - Carveouts

- Standard/accepted carveouts/exceptions to MAC
  - Announcement of deal/identity of buyer
  - Changes in general economic, financial or political conditions
  - General changes in target's industry
  - Changes in laws or GAAP
  - Securities markets
  - Acts of terrorism or war
  - Decrease in stock price
  - Failure to meet earnings estimates
  - Actions due to buyer's request or required by the agreement
- These MAC exclusions are the real focus of the negotiations in which parties allocate risk
- Carveout to carveout – for "disproportionate effects on target"

Financing Contingencies - Assurance at Signing

- Commitment
  - Purports to be legally binding
    - Not all terms included, even in long form
    - Sponsor precedent
  - Conditions may not parallel acquisition agreement
    - Material adverse change definition
    - Financial market status
    - Solvency
    - Specific financial metrics
  - Seller/target not party
  - Different governing law/forum selection from acquisition agreement

Financing Contingencies - Assurance at Signing

- Credit agreement
  - Difficult to negotiate at same time as acquisition agreement
    - Participation of target management may be necessary
  - Not common in U.S. practice
    - Transactions subject to U.K. Takeover Code
  - While legally binding contract still subject to limitations
    - Conditions may not parallel acquisition agreement
    - Seller/target not parties
    - Different governing law/forum selection from acquisition agreement

Financing Contingencies - Consequences of Failure

- Financing condition
  - Buyer is excused from performance if financing unavailable
    - Seller/target has no recourse except to claim covenant breach
  - Rare in acquisitions of public companies and becoming less common in acquisitions of private companies

Financing Contingencies - Consequences of Failure

- Reverse Termination Fee
  - Buyer is excused from performance, and is required to pay a reverse termination fee, if financing is unavailable
    - Agreement and Plan of Merger made as of March 8, 2009, by and among Merck & Co., Inc., a New Jersey corporation, Schering-Plough Corporation, a New Jersey corporation, Blue, Inc., a New Jersey corporation, and Purple, Inc., a New Jersey corporation – Merck is excused from performance, but has to pay a reverse termination fee, if financing unavailable
- Reverse Termination Fee in some circumstances
  - Buyer is excused from performance, and is required to pay a reverse termination fee if financing unavailable for specified reasons
    - Agreement and Plan of Merger, dated as of January 25, 2009, among Pfizer Inc., a Delaware corporation, Wagner Acquisition Corp., a Delaware corporation and Wyeth, a Delaware corporation – Pfizer is excused from performance, but has to pay a reverse termination fee, if financing unavailable to Pfizer primarily as a result of a rating downgrade or a MAC. Specific performance available if financing unavailable for any other reason

Financing Contingencies - Consequences of Failure

- Unlimited exposure
  - Failure to obtain financing does not excuse performance or limit contract remedies – seller/target can seek full contract damages or specific performance
    - However, there are practical difficulties with both types of remedy
    - This is the most common structure in recent acquisitions of public companies

Reverse Termination Fees ("RTF")

- The RTF was originally based on a termination fee
- Typical Termination ("break-up") fees
  - A "public deal" convention - cannot preclude a "superior proposal"
  - Paid by Seller/Target, the party terminating to enter into "superior proposal" or whose board withdrew its recommendation
  - 2% - 5% of equity value
  - Separate expense reimbursement (not always)

Reverse Termination Fees

- As financing outs faded away, RTFs appeared to shield the risk of obtaining financing
- Payable on breach of agreement by buyer or in case of a financing failure
- Similar to the standard termination fee, the RTF <u>was</u> around 3% of the deal's equity value
- If PE buyer refused to close for any reason, seller's sole remedy was the RTF
- Sometimes the RTF was a cap on damages that would need to be proven (not automatically payable)
- Seller friendly provision? Not so, but better than a financing out

Reverse Termination Fees

- Sellers expressed shock that the "pure" RTF was really an option
- Buyers asserted that it was absolutely an option
- Despite initial negative reactions, RTFs endure today, and could be considered the norm
- Payable for breach of buyer / failure to obtain financing
- Two-tier RTF
  - Willful breach – higher RTF payable
  - Not willful breach – lower RTF payable
- Also payable for non consummation of the deal for any reason, failure to obtain regulatory approval, other closing failures, etc.

RTFs - Takeovers Gone Bad

- With RTFs in hand, PE buyers (eventually strategic buyers too), were emboldened
  - Believed they had effectively capped damages
  - Asserted MAC and other closing condition failures
  - Target faced with complex and protracted litigation
  - Target's business deteriorating (economy was getting worse by the day)
  - Negotiate a termination on terms more favorable to buyer than the agreed upon RTF
  - Claims of Insolvency by buyers and banks
- Target/Seller sometimes had the specific performance provision on their side to battle the notion of capped damages, but it was at best ambiguous

Specific Performance

- Specific performance is intended to permit a party to force the other party to perform
  - Avoids need to establish damages and provides seller/target the full benefit of its bargain
    - Damages can be difficult to prove

Specific Performance

- As an equitable remedy, grant of specific performance is traditionally subject to Court's discretion
  - However, in the M&A context Delaware Courts will generally follow contract
  - Contract provisions excluding or limiting specific performance are respected
  - No clear authority as to whether contract provisions calling for specific performance eliminate Court's discretion
- Ability to customize in contract
  - May be available against only one party (generally target)
  - May be available for all obligations or all obligations other than closing

Specific Performance

"The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached and that the parties would not have any adequate remedy at law. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches or threatened breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement ...The foregoing is in addition to any other remedy to which any party is entitled at law, in equity or otherwise."

Specific Performance

"The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed by the Company in accordance with their specific terms or were otherwise breached by the Company. It is accordingly agreed that, prior to the termination of this Agreement pursuant to Section 8.1, Holdings and Merger Sub shall be entitled to an injunction or injunctions to prevent breaches of this Agreement by the Company and to enforce specifically the terms and provisions of this Agreement against the Company, this being in addition to any other remedy to which either such party is entitled at law or in equity. The Company acknowledges and agrees that it shall not be entitled to an injunction or injunctions to prevent any breaches of this Agreement by Parent, Holdings or Merger Sub or to enforce specifically the terms and provisions of this Agreement or otherwise to obtain any equitable relief or remedy against Parent, Holdings or Merger Sub and that the Company's sole and exclusive remedies with respect to any such breach shall be the remedies set forth in Section 8.2(c) [fees and expenses]; provided, however, that the Company shall be entitled to any injunction or injunctions solely to prevent any breach by Holdings or Merger Sub of Section 6.4(b) [confidentiality]."

EARN OUT AGREEMENT

THIS EARN OUT AGREEMENT (the "Agreement") is made as of this ___ day of _________, 20__, by and among RUM & COLA, INC. (the "Purchaser"), and BLUE DUCK CORP. (the "Seller").

RECITALS:

A. In accordance with that certain Asset Purchase Agreement (the "Purchase Agreement") dated as of even date herewith between Seller and Purchaser, Seller has sold to Purchaser substantially all of the assets of Seller used or held for use in the Business.

B. In accordance with the terms of the Purchase Agreement, the parties hereto desire to enter into this Agreement to provide for the calculation and payment of the additional Purchase Price which is payable by the Purchaser in consideration of the transaction set forth in the Purchase Agreement.

NOW, THEREFORE, in consideration of the covenants herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Defined Terms. All capitalized terms not otherwise defined herein shall have the meanings set forth in the Purchase Agreement. As used in this Agreement, the following terms shall have the following meanings:

"**Contribution Levels**" means net sales of Purchaser with respect to the Products, less of cost of goods sold, distribution expenses, selling expenses, and other expenses of Purchaser with respect to the Products, as set forth in Exhibit B attached hereto and incorporated herein by reference, all as determined by Purchaser in accordance with GAAP.

"Earn Out Payments" means those payments by Purchaser to Seller referred to in Section 3 of this Agreement.

"Earn Out Periods" means each Fiscal Year with respect to which Earn Out Payments come due under this Agreement with the first Earn Out Period beginning on the date of Closing and the last Earn Out Period ending in the quarter of the Fiscal Year that the maximum cumulative amount of Earn Out Payments contemplated by this Agreement have accrued or, if earlier, the expiration date referred to in Section 3 of this Agreement.

"Fiscal Year" means the twelve (12) month period commencing on January 1 of each calendar year and ending on December 31 of such calendar year. To the extent this Agreement refers to a quarterly period within a Fiscal Year, such reference shall mean the three (3) month periods ending March 31, June 30, September 30 and December 31 of each Fiscal Year.

"GAAP" means United States generally accepted accounting principles in effect on the date of this Agreement, applied consistent with the practices of Purchaser and consistently throughout the period involved.

"Person" means any individual, corporation, association, partnership (general or limited), joint venture, trust, estate, limited liability company or other legal entity or organization.

"Products" shall mean the products which are identified on Exhibit A attached hereto and incorporated herein by reference. The products identified on Exhibit A may be amended from time to time by mutual agreement in writing of the parties hereto in the exercise of their respective sole discretion.

2. Operations.

2.1 Records, Reports and Accounting Matters.

2.1.1 Records. As a part of its regular operations, the Purchaser shall maintain in accordance with GAAP books of account and records from which Contribution Levels can be determined.

2.1.2 Reports. Purchaser agrees to deliver to Seller on or before the forty-fifth (45^{th}) day following the end of each of the first three quarterly periods (or portion thereof) included within the Earn Out Periods a written statement, showing the amount of Contribution Levels in the preceding quarterly period. With respect to quarterly periods ending at the expiration of an Earn Out Period, Purchaser agrees to deliver to Seller on or before the ninetieth (90^{th}) day following the end of such Earn Out Period a written statement, showing the amount of Contribution Levels during the preceding Earn Out Period.

2.1.3 Audits. Within thirty (30) days after receipt of an annual statement, Seller shall notify the Purchaser in writing as to whether Seller (i) has any objections to the Purchaser's determination (an "Objection Notice"), or (ii) desires to exercise its right to a Seller's audit (as described below). Within one month following delivery of an Objection Notice, Seller and Seller's authorized representative shall have the right during regular business hours to examine the Purchaser's books of account and records to verify and tabulate Contribution Levels with respect to the preceding Earn Out Period; provided that (a) Seller may not exercise its audit right more than once with respect to any Earn Out Period, (b) such audit shall be conducted in a manner which does not interfere in any material respect with the operation of the business of the Purchaser or any of its affiliates and (c) such audit must be completed within a reasonable time which shall not, in any event (assuming Purchaser has timely made available to Seller the necessary books and records to complete Seller's audit), be longer than two (2) months after delivery of the Contribution Level amounts for any Earn Out Period. All such books of account and records shall be made available for such examination at the office where same are regularly maintained by the Purchaser. Any information obtained by Seller as a result of such audit shall be treated as confidential, except to the extent necessary to enforce any parties' rights in any litigation or proceeding and except where otherwise required by law. If Seller notifies the Purchaser that, as a result of Seller's audit, it disagrees with the Purchaser's determination of Contribution Levels, Seller shall provide a reasonably detailed explanation of Seller's disagreement with the Purchaser's determination provided that such notice must be given within two (2) months after delivery of the Contribution Level amounts for any Earn Out Period. If Seller and the Purchaser are unable to resolve any disagreements on accounting issues affecting the amount of Contribution Levels within thirty (30) days (or such longer period as Seller and the Purchaser may mutually agree) of Seller's notification of its disagreement with the

Purchaser's determination, the determination of the amount that the parties cannot agree to will be submitted by the Purchaser and/or Seller for binding arbitration to a mutually agreeable "Big 3" accounting firm (the "Arbitrating Accountant") for determination of the amount of such disputed item only; provided, that only matters relating to accounting issues under GAAP shall be submitted to the Arbitrating Accountant. The Arbitrating Accountant's determination of said amount(s) shall be final and binding on the parties, provided that the amount(s) so determined shall be within the applicable range between the amounts determined by the Purchaser and Seller such that, after the determination by the Arbitrating Accountant, the Earn Out Payment shall not exceed that requested by Seller or be less than that requested by the Purchaser. The Arbitrating Accountant's expenses shall be borne by the party whose determination of the disputed amount or amounts is furthest from the amount determined by the Arbitrating Accountant. When agreed to by the parties or determined by the Arbitrating Accountant, as the case may be, the Purchaser shall, within ten (10) days after such agreement or determination, as the case may be, pay Seller by wire transfer of immediately available funds the agreed to Earn Out Payment. Any Earn Out Payment not made on or prior to the 45th day after the close of the quarterly period to which it relates or the 90th day with respect to the close of an Earn Out Period shall accrue interest at the rate of eight percent (8%) per annum from such date.

3. Earn Out Payments.

3.1 Condition Precedent to Earn Out Payments. As a condition precedent to the obligation of Purchaser to pay any Earn Out Payments under this Agreement, a cumulative Contribution Level of $[insert de minimis amount] must have been attained, and no Earn Out Payments shall accrue or become payable until this cumulative Contribution Level is attained.

3.2 Amount of Payments. Subject to the satisfaction of the condition set forth in Section 3.1 of this Agreement, as additional consideration for the transactions set forth in the Purchase Agreement, Purchaser shall pay to Seller an amount (the "Earn Out Payments") equal to 25% of the Contribution Level for each Earn Out Period; Earn Out Payments shall be determined and paid with respect to each quarterly period during each of the Earn Out Periods concurrently with the delivery by Purchaser to Seller of a report showing the computation of Earn Out Payments due under this Agreement for the Earn Out Period, subject to Section 3.1. At the end of each Earn Out Period, the Earn Out Payment shall be adjusted on the basis of a complete Earn Out Period with appropriate adjustments made for any reconciling adjustments associated with Earn Out Payments earlier made for a portion of such Earn Out Period. In no event shall the total Earn Out Payments payable by Purchaser under this Agreement exceed $[insert maximum amount].

3.3 Expiration of Obligation. Purchaser's obligation to accrue, calculate or make Earn Out Payments to Seller shall terminate and expire ___________, 20__ [usually no more than five years], regardless of whether or not the maximum cumulative amount of Earn Out Payments contemplated by this Agreement shall have previously accrued.

4. Arbitration. Except with respect to accounting issues to be submitted to the Arbitrating Accountant as set forth in Section 2.1.3, all disputes, controversies, or claims arising out of or relating to this Agreement shall be resolved by agreement among the parties or, if notice is given by any of the parties as provided below and the matter is not otherwise resolved, arbitration in New York, New York, by one arbitrator under the then-effective Commercial Arbitration Rules (the "Rules") of the American Arbitration Association ("AAA") with pre-

hearing discovery rights in accordance with the Federal Rules of Civil Procedure, and otherwise as modified by this Agreement, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction. The award rendered by the arbitrator shall be final and binding on the parties and not subject to further appeal. Such arbitration may be initiated by written notice by either party to the other party. The arbitrator shall be selected by the parties in accordance with the Rules and shall be a practicing attorney or a retired judge having at least twenty (20) years of experience in matters relating to business and commercial transactions. Each party agrees to pay an equal part of the deposit fixed by the AAA or the arbitrator. Each party shall bear its own attorneys' fees and other experts' fees and related costs. The arbitrator shall not have the authority to award punitive damages but may, in the discretion of the arbitrator, award attorneys' fees and costs to the prevailing party in any such arbitration proceedings.

5. No Implied Duty of Purchaser. Purchaser has advised Seller that any number of risks and other business factors may affect the business plans of Purchaser with respect to the Business. PURCHASER MAY REVISE ITS BUSINESS PLANS (WHICH REVISIONS MAY INCLUDE, WITHOUT LIMITATION, TERMINATION OF ONE OR MORE OR ALL COMPONENTS OF THE BUSINESS WHICH MAY RESULT IN THE REDUCTION OR ELIMINATION OF EARN OUT PAYMENTS) WITH RESPECT TO THE BUSINESS IN THE SOLE AND ABSOLUTE DISCRETION OF PURCHASER WITHOUT ANY LIABILITY OR RESPONSIBILITY TO SELLER. Without limiting the generality of the foregoing, Purchaser undertakes no implied obligation to the Seller by reason of this Agreement to maximize the amount of Earn Out Payments payable under this Agreement or to satisfy any condition to payment of Earn Out Payments.

6. Miscellaneous Provisions.

6.1 Modification. This Agreement may not be changed or modified except in writing specifically referring to this Agreement and signed by all of the parties to this Agreement.

6.2 Assignments; Successors and Assigns. As a condition to the sale or transfer of any of the assets of the Purchaser as would constitute a transfer of all or substantially all of the business of selling the Products (a) the Purchaser shall notify Seller, (b) the transferee shall assume the obligations of the Purchaser hereunder subject to the terms and conditions of this Agreement, and (c) the Purchaser shall no longer have any liability or obligation hereunder. The terms and provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns. Any assignment of this Agreement by Seller shall require the prior written consent of Purchaser.

6.3 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

6.4 Notices. All notices, demands, requests or other communications that may be or are required to be given, served or sent by any party to any other party pursuant to this Agreement shall be in writing and shall be mailed by first-class, registered or certified mail, return receipt requested, postage prepaid, or transmitted by a reputable overnight courier service or by hand delivery, addressed as follows:

(i) If to Seller:

[ ]

(ii) If to Purchaser:

[ ]

or at such other address as any party hereto notifies the other parties hereof in writing. The parties hereto agree that notice or communications that are given in accordance herewith by personal delivery will be deemed effective on delivery thereof to the receiving party, by overnight delivery will be deemed effective on the first business day immediately following the date sent and by U.S. mail, will be deemed effective three business days immediately following the date sent. For the purposes of this Agreement, a "business day" is day on which U.S. national banks are open for business and shall not include a Saturday or Sunday or legal holiday.

6.5 Entire Agreement. This Agreement constitutes the entire agreement of the parties hereto with respect to the subject matter hereof, and supersedes any and all prior agreements and undertakings, both written and oral, among the parties, or any of them, with respect to the subject matter hereof.

6.6 Governing Law. Except as otherwise expressly provided herein, this Agreement shall governed by and construed under the laws of the State of New York, without regard to the conflicts of law provisions thereof.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

SELLER:

BLUE DUCK CORP.

By:________________________________

Its: ________________________________

PURCHASER:

RUM & COLA, INC.

By:________________________________

Its:________________________________

<u>EXHIBIT A</u>

Blue Duck Premium Vodka

EXHIBIT B

Earn Out Schedule

I. Definitions for the purpose of the Earn Out Schedule:

Net Revenues – Shall be defined as sales of products listed in Exhibit A net of returns, rebates, or discounts

Cost of Goods Sold – The standard cost of finished goods sold plus or minus any variances from standard cost

Distribution Expense – The expenses associated with shipping product to the end customer

Direct Selling Expense – The expenses under the direct control of [chief financial officer] associated with generating revenue

Indirect Selling Expense – Shall be defined as a charge of __% of revenues generated by the Rum & Cola, Inc. domestic sales force

Direct Administrative Expense – The expenses under the direct control of [chief financial officer] associated with general and administrative functions of the home office

Contribution – The net effect of Net Revenues less Cost of Goods Sold, Distribution Expense, Direct Selling Expense, Indirect Selling Expense, and Direct Administrative Expense

Although companies that are engaged in discussions regarding a potential merger or acquisition have genuine business reasons to exchange information about their respective businesses, the antitrust laws impose important limits on their dialogue and exchange of competitively sensitive information. This is particularly the case when the companies are competitors. As a general rule, until the actual time that a transaction is consummated, the parties to negotiations need to keep competitively sensitive information confidential, to consider their respective businesses as independent of each other, and to engage in business as usual.

Legal Background

Section 1 of the Sherman Act prohibits certain collaborative efforts between competitors. During negotiations for a possible transaction, exchanging competitively sensitive information may arguably violate the Sherman Act because the information could provide the basis of coordination of prices or allocation of territories if no transaction ultimately takes place.

In addition, companies planning a transaction that is valued at greater than $65 million may be subject to the premerger filing requirements of the Hart-Scott-Rodino Act (HSR Act). The HSR Act was designed to provide the government opportunity to consider possible anticompetitive effects of a planned transaction before the businesses are combined. Hence, this statute requires that the parties to a reportable transaction take no action that would transfer beneficial control of assets or would allow the purchaser to make business decisions for the company to be acquired until they have completed their HSR filing and observed a statutory waiting period (typically 30 days, which may be elongated in certain circumstances). The waiting period provides government authorities time to consider whether the transaction raises anticompetitive issues and to seek to block the transaction if necessary. If parties prematurely exchange competitively sensitive information, the government may argue that the HSR Act has been violated because the competitive potential of one or both companies has been diminished and the competitive status quo cannot be re-established.

Antitrust Ground Rules for Negotiations

- **Parties negotiating a transaction should not exchange competitively sensitive information unless they do so pursuant to antitrust advice.** Competitively sensitive information is information that, in the hands of a competitor, could harm the competitive potential of one or both parties if the transaction is not ultimately consummated. Exactly what information is competitively sensitive differs for each transaction. In most circumstances, however, competitively sensitive for antitrust purposes is the same information that a business person would be uncomfortable disclosing outside the company because the disclosure could weaken the business. Company officials should seek antitrust advice before disclosing information to the other party (or seeking to obtain information from the other party) if that information could weaken either company should the transaction be abandoned.

- **Specific types of information raise the greatest antitrust concerns.** Discussions that are particularly suspect under the antitrust laws include those that relate to:
  -- current and future prices,
  -- proprietary information regarding research and development,

-- production costs,
-- future product and development plans,
-- marketing strategies for the future,
-- unannounced expansion plans,
-- detailed customer and contract information, and
-- long range plans.

As a general matter, exchanging historical information is not problematic.

- **The Sherman Act carries both civil and criminal penalties**. Executives of competing companies need to be extremely cautious to avoid potential liability for their companies and themselves under the Sherman Act. The government may bring criminal charges against individuals or their companies, and these can entail both significant fines for a company as well as personal liability and jail time for individuals. In addition, civil suits brought under the Sherman Act may provide trebled damages to a successful private plaintiff.

- **Neither company should suggest anything that might be construed as collaborating on any business decisions.** Until the final closing on a transaction, each company must remain in control of its own business decision-making.

- **Valuation and due diligence may require disclosure of competitively sensitive information at some point, but this should be done within the confines of specific antitrust advice.** For a transaction to go forward from initial stages to more serious consideration, certain confidential information may need to be disclosed by parties to a transaction (while some information should not be disclosed until consummation). We can develop safe means to exchange most information that needs to be exchanged, often either by aggregating data or providing historical information rather than current information or by identifying three or four key executives (often called a "clean team") to receive the confidential information. The clean team should be made up of individuals who do not know and will not in the future (unless the deal is consummated) be engaged in the most competitively sensitive aspects of the business that competes with the other parties' competing business -- such as setting prices, marketing strategies or developing new products. The clean team agrees not to make use of or disclose any competitively sensitive information to others in their company.

July 9, 2019

FAQs on the Foreign Investment Risk Review Modernization Act (FIRRMA) and the CFIUS Pilot Program

Advisory

By John P. Barker, John B. Bellinger, III, Charles A. Blanchard, Ronald D. Lee, Nancy L. Perkins, Nicholas L. Townsend

I. CFIUS's Expanded Jurisdiction Under FIRRMA

1. What is CFIUS and how is it relevant to investments by funds?

CFIUS is the Committee on Foreign Investment in the United States, an interagency committee that reviews and investigates certain investments by "foreign persons" in any "U.S. business" to determine if the investment could impair U.S. national security. Both "foreign person" and "U.S. business" have broad meanings in this context. A "foreign person" includes foreign citizens, entities organized under laws other than those of the United States, and entities organized under U.S. state or federal law that are controlled by a foreign person. A "U.S. business" is any entity "engaged in interstate commerce in the United States," regardless of the nationality of the person or persons who control it.

CFIUS has authority to recommend that the President, pursuant to Section 721 of the Defense Production Act, as amended (Section 721), block or unwind investments subject to the statute ("covered transactions") based on concerns for U.S. national security. Many funds that are "foreign persons" invest in U.S. businesses, and where these investments constitute "covered transactions," under Section 721, CFIUS could recommend that they be blocked or otherwise interfered with by the President.

2. What is FIRRMA and what did it change?

FIRRMA is the Foreign Investment Risk Review Modernization Act of 2018, which was enacted on August 13, 2018, as part of the National Defense Authorization Act of 2019 (NDAA). FIRRMA amended Section 721 to expand the jurisdiction of CFIUS substantially. Prior to the enactment of FIRRMA, the investments subject to CFIUS review (i.e., "covered transactions") were limited to "[a]ny merger, acquisition or takeover . . . by or with any foreign person that could result in foreign control of any U.S. business, including such a merger, acquisition or takeover carried out through a joint venture."

CFIUS's broader jurisdiction under FIRRMA includes the review of any "other investment" (i.e., a non-controlling investment) by a foreign person in any U.S. business that (i) owns, operates, manufactures, supplies, or services "critical infrastructure"; (ii) produces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies"; or (iii) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security. As discussed below, a subset of these "other investments" are now subject to mandatory CFIUS filing under CFIUS's pilot program.

Although some provisions of FIRRMA became effective immediately upon the law's enactment, the provisions expanding the types of "covered transactions" to include "other transactions" take effect considerably later—on the earlier of (i) 18 months after FIRRMA's enactment (i.e., February 13, 2020) or (ii) 30 days after publication in the Federal Register of a determination by the CFIUS Chair that the regulations, organizational structure, personnel, and other resources necessary to administer those new provisions are in place. However, as discussed below, CFIUS currently is conducting a pilot program that imposes requirements on parties to certain "other investment" transactions.

3. How does CFIUS define "other investments"?

"Other investments" subject to CFIUS review under FIRRMA include any investment, direct or indirect, that affords the foreign person (i) access to any material non-public technical information in the U.S. business' possession (excluding the U.S. business' financial information); (ii) membership or observer rights on the board of directors or equivalent governing body or the right to nominate an individual to such a position; or (iii) any involvement (other than through voting of shares) in substantive decision-making of the U.S. business regarding the use, development, acquisition, safekeeping, or release of critical technologies or sensitive personal data of U.S. citizens, or regarding the management, operation, manufacture, or supply of critical infrastructure.

4. What are "critical technologies"?

FIRRMA defines "critical technologies" as including (1) defense articles and defense services included on the United States Munitions List set forth in the International Traffic in Arms Regulations (ITAR); (2) certain items controlled under the Commerce Department's Commerce Control List of the Export Administration Regulations (EAR); (3) nuclear facilities, equipment, and material; (4) select agents and toxins; (5) and emerging and foundational technologies controlled pursuant to the Export Control Reform Act of 2018 (ECRA). CFIUS will further define these terms through regulation, and, as discussed below, the Commerce Department will identify emerging and foundational technologies and impose restrictions on the export, reexport, and in-country transfers of such technologies. By statute, the Commerce Department must require a license for the export of emerging and foundational technologies to China and other countries subject to a U.S. embargo.

5. How do I know if my company's technology constitutes "emerging or foundational technology"?

The scope of "emerging and foundational technologies" will be determined by an interagency process that will consider both public and classified information as well as information from the Emerging Technology Technical Advisory Committee (formerly known as the Emerging Technology and Research Advisory Committee) and CFIUS. This interagency process is anticipated to result in proposed rules for new Export Control Classification Numbers (ECCNs) on the Commerce Department's Commerce Control List. As emerging and foundational technologies are identified and become controlled under the ECRA, they will be covered under the definition of "critical technologies" in the CFIUS regulations. CFIUS is not creating a separate definition of emerging and foundational technologies outside the interagency process outlined by the ECRA.

6. When will the process of defining "emerging or foundational technologies" occur?

It has already started. On November 19, 2018, the Commerce Department's Bureau of Industry and Security (BIS) published an Advance Notice of Proposed Rulemaking (ANPRM) in the Federal Register seeking public comment on the criteria for identifying emerging technologies that are essential to U.S. national security.[1] Comments submitted on this ANPRM will help inform the interagency process to identify and describe such emerging technologies. BIS is expected to issue a separate ANPRM regarding criteria for identifying foundational technologies that may be important to U.S. national security.

[1] *See* 83 Fed. Reg. 58201 (Nov. 19, 2018) and 83 Fed. Reg. 64299 (Dec. 14, 2018) (extending the public comment period until Jan. 10, 2019).

7. Which technologies are likely to be identified as "emerging or foundational technologies"?

The Commerce Department's ANPRM suggests that the emerging technologies subject to additional government regulation could include any of the following:

(1) Biotechnology
(2) Artificial intelligence and machine learning technology
(3) Position, navigation and timing technology
(4) Microprocessor technology
(5) Advanced computing technology
(6) Data analytics technology
(7) Quantum information and sensing technology
(8) Logistics technology
(9) Additive manufacturing (e.g., 3D printing)
(10) Robotics
(12) Brain-computer interfaces
(13) Hypersonics
(14) Advanced materials
(15) Advanced surveillance technologies

8. Will there be heightened scrutiny of investments from certain countries?

FIRRMA does not identify by name any countries from which investment will be subject to heightened scrutiny. However, the legislation encourages CFIUS, when evaluating national security risks, to consider whether a covered transaction involves a country of special concern that has a demonstrated or declared strategic goal of acquiring a type of critical technology or critical infrastructure that would affect U.S. leadership in areas related to national security.

The legislation also directs CFIUS to define further the term "foreign person" for purposes of reviews of "other investments," so that the scope of such reviews will depend in part on connections the investor may have with particular countries or the governments of such countries, where such connections may affect the national security of the United States.

Given the heightened sensitivity to investments from China, parties engaged in transactions involving a Chinese investor should be prepared to consider possible mitigation measures that would preclude the foreign investor's influence over the U.S. business or exposure to sensitive information.

II. FIRRMA's Impact on Venture Capital, Private Equity, and Other Investment Funds

1. How are investment funds affected by FIRRMA?

FIRRMA may impact the structuring of investment funds and the manner in which they structure investments and interact with their investors—particularly for (1) funds focused on investing in businesses developing any type of critical technology or critical infrastructure, or in businesses with access to sensitive personally identifiable information, (2) funds with significant investor participation from certain non-U.S. jurisdictions, and (3) managers utilizing alternative structures or structures that provide investors with greater participation, access, and information than customary for traditional well-established funds.

FIRRMA's "other investment" provision could expand dramatically the number of transactions reviewable by CFIUS. It is not uncommon for minority, non-controlling fund investors to seek representation on a board of directors. A typical minority investment in an advanced technology company could be subject to CFIUS review under FIRRMA.

Managers of investment funds should be aware that there is no size limitation on transactions subject to FIRRMA, because of congressional concern around foreign investment in and acquisition of emerging technologies considered critical to U.S. national security. Thus, small funds and funds focused on minority and seed or other early stage investments, including as part of an accelerator or incubator, need to consider potential CFIUS implications when structuring their funds.

2. What if a foreign person's role in a fund is passive?

During the legislative process, many investment firms expressed concern that the "other investment" provision of FIRRMA would apply to virtually all of their transactions, because they have foreign investors. This resulted in a carve-out: even if a foreign person invests through a fund in a U.S. business, and, as a limited partner or the equivalent, is on an advisory board or a committee of the fund, the investment is not an "other investment" if: (i) the fund is managed exclusively by a general partner, a managing member, or an equivalent who is a U.S. person; (ii) the advisory board or committee does not have the ability to approve, disapprove, or otherwise control investment decisions of the fund, and the foreign person does not otherwise have the ability to control the fund; and (iii) the foreign person does not have access to material non-public technical information by participating on the advisory board or committee.

3. How do I determine if a fund is controlled by a "U.S. general partner or equivalent" for CFIUS purposes?

The safe harbor described in Question 2 above is available only for funds managed by a U.S. general partner or equivalent. CFIUS tends to review nationality of the general partner from both a formal (e.g., the jurisdiction of incorporation or organization of the general partner) as well as a substantive perspective (e.g., who controls the legal entity that is the general partner).

CFIUS defines "control" expansively as "the power, direct or indirect, whether exercised or not exercised, to determine, direct, or decide important matters affecting an entity." This broad definition of "control" means that fund managers need to exercise care in structuring the general partnership and in allowing anchor investors or other limited partners control over certain or all aspects of the general partnership or its investment process, including potentially removal and/or replacement provisions of the general partner or its key personnel.

4. What information can a fund provide to non-U.S. investors without triggering CFIUS concerns?

Foreign investors are permitted explicitly to receive financial information, both at the fund level and with respect to specific fund investments. Information that foreign investors are not permitted to receive—referred to as "material nonpublic technical information"—is defined as information that (i) provides knowledge, know-how, or understanding, not available in the public domain, of the design, location, or operation of critical infrastructure; or (ii) is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods.

A wide range of information will not be either financial information or material nonpublic technical information, such as business plans and product development roadmaps. Fund managers will need to consider carefully what information rights can be provided to foreign investors in a fund without creating an “other transaction” under CFIUS jurisdiction.

III. CFIUS Procedural Changes Under FIRRMA: Declarations, Filing Fees, and Extended Review Periods

1. How have CFIUS filings changed under FIRRMA?

Previously, there was no requirement that the parties to a covered transaction notify CFIUS of the transaction. But parties to a covered transaction often chose to file voluntarily a “notice” with CFIUS, seeking CFIUS’s confirmation that the investment would not be blocked by the President. Because Section 721 permits the President to order divestiture by a foreign investor after-the-fact, it has been in the interest of parties to foreign investment transactions that have potential national security implications to file a notice with CFIUS before undertaking the transaction. Undergoing a CFIUS review is the only mechanism through which to obtain assurance that the President will not exercise his authority under Section 721 to interfere with the transaction. Filing notices with CFIUS in many (if not most) cases remains voluntary under FIRRMA. However, FIRRMA requires CFIUS to issue regulations that make it mandatory for the parties to certain transactions to file “declarations” regarding their proposed deals. Such declarations are shorter than notices to CFIUS (they may be no longer than five pages) and they must be submitted more than 45 days before the closing of the relevant transaction. Notices must provide a considerable amount of additional information on the transaction and the parties to the transaction, as specified in CFIUS’s regulations pre-existing FIRRMA. Parties submitting a declaration must use this form and follow the instructions.

Severe penalties can be imposed on parties who fail to file declarations when it is mandatory to do so. As discussed below, under interim regulations issued by CFIUS in late 2018, filing a declaration currently is mandatory with respect to any “Pilot Program Covered Transaction.” CFIUS is not currently accepting voluntary declarations.

Whether filing a declaration is mandatory or not, FIRRMA permits the parties to a covered transaction to file a notice rather than a declaration. Because declarations are less detailed and extensive than notices, and because there is no fee for filing a declaration (*see* FAQ on filing fees below), filing declarations may be an attractive option for the parties to relatively routine covered transactions that seem unlikely to implicate national security concerns. In addition, CFIUS must complete its review of a declaration within **30 days**—as opposed to the 45-day period CFIUS has to review a notice. Thus, although there is a risk that CFIUS, after reviewing a declaration, will request the parties to file a full “notice” as well (*see* FAQ below on what is involved in a CFIUS review), for transactions that do not appear to raise serious national security concerns, parties may wish to file a declaration rather than a full notice. Conversely, where a transaction seems to have the potential to cause concern for CFIUS, the parties should consider skipping the filing of a declaration and proceeding directly to filing a notice.

2. Is there a fee for initiating a CFIUS review?

FIRRMA authorizes CFIUS to assess, for the first time, a fee for the filing of a notice of a covered transaction. This authority does not extend to filing declarations (either under mandate or voluntarily). Thus, while there are efficiency reasons for filing a notice and not a declaration, cost considerations made lead parties to file declarations in the first instance. Although CFIUS has yet to issue regulations regarding its assessment of fees for filing notices, by statute, it may impose a fee of up to one percent of the transaction value or $300,000 (adjusted for inflation), whichever is less.

3. What is the timing of a CFIUS review?

The previous statutory framework authorized CFIUS to conduct a 30-day review and an optional, subsequent 45-day investigation after receiving a notice of a covered transaction. FIRRMA extends the initial review period for a notice to 45 days, retains the 45-day investigation period, and provides for one 15-day extension for extraordinary circumstances. Thus, the notice review period could last up to 105 days, instead of the previous 75 days. However, the 15-day extension may permit CFIUS to complete some reviews without requiring parties to withdraw and resubmit their notices (a practice CFIUS exercised pre-FIRRMA), thereby restarting the review clock. As noted, CFIUS's review of a declaration is statutorily limited to 30 days.

4. What is involved in a CFIUS review?

By law, CFIUS treats as confidential all declarations and notices (other than in certain circumstances, such as disclosures to members of Congress) and not subject to disclosure under the Freedom of Information Act. Upon receiving a complete declaration, CFIUS has the discretion to:

(1) request that the parties to the transaction file a formal written notice;

(2) inform the parties to the transaction that CFIUS is not able to conclude all proceedings under Section 721 on the basis of the declaration and that the parties may file a formal written notice to request that CFIUS conclude all action under Section 721 with respect to the transaction;

(3) initiate a 45-day review of the transaction based on CFIUS's authority to self-initiate reviews; or

(4) notify the parties in writing that CFIUS has concluded all action under Section 721 with respect to the transaction.

IV. CFIUS's Pilot Program

1. What is the CFIUS pilot program?

FIRRMA authorizes CFIUS to conduct one or more pilot programs to implement any provisions of the legislation that were not immediately effective upon enactment. On October 10, 2018, the Treasury Department released interim regulations establishing a pilot program (officially called a "Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies"), which requires declarations to CFIUS for certain planned transactions involving foreign investment in certain U.S. businesses that produce, design, test, manufacture, fabricate, or develop one or more critical technologies.

The interim regulations require that the parties to any "pilot program covered transaction" submit either a declaration (as described above) or, at the option of the parties, a notice (which must contain the detailed information required under the CFIUS rules for voluntary notifications to CFIUS). Failure to submit at least a declaration could result in a civil monetary penalty up to the value of the transaction.

The Pilot Program regulations will remain in force until final regulations implementing FIRRMA are adopted, which FIRRMA specifies must be on or before March 5, 2020.

2. What transactions are subject to the Pilot Program?

The interim regulations require submission of a declaration (or, at the parties' discretion, a full notice of the nature prescribed in the current CFIUS regulations) to CFIUS of any "pilot program covered transaction," which is defined as:

(1) any transaction by or with any foreign person that could result in foreign control of any "pilot program U.S. business," including such a transaction carried out through a joint venture; or

(2) any "pilot program covered investment."

The first category includes transactions that have been "covered transactions" under the CFIUS regulations for years—i.e., transactions in which a foreign person (including a U.S. entity that is controlled by a foreign person or entity) will gain "control" over important decisions of a U.S. business.

The second category, called "pilot program covered investment," covers any non-controlling foreign investment in a "pilot program U.S. business" if it would afford the foreign investor (i) access to material nonpublic technical information held by the pilot program U.S. business; (ii) membership or observer rights on the board of directors or similar governing body of the pilot program U.S. business; or (iii) the right to appoint a member of the pilot program U.S. business' board of directors; or (iv) any involvement,[2] beyond the mere voting of shares, in substantive decision-making[3] regarding the pilot program U.S. business' use, development, acquisition, or release of critical technology.

3. How do I determine whether a company is a pilot program U.S. business?

Pursuant to 31 CFR 801.213, a U.S. business meets the definition of a "pilot program U.S. business" if it produces, designs, tests, manufactures, fabricates, or develops a critical technology that is (a) utilized in connection with the U.S. business's activity in one or more pilot program industries; or (b) designed by the U.S. business specifically for use in one or more pilot program industries (i.e., the industries identified in Annex A to 31 CFR part 801). See Appendix below for the list of the pilot program industries.

The first step is to determine, if not already known, whether the U.S. business produces, designs, tests, manufactures, fabricates, or develops a critical technology. This will involve considering everything that the U.S. business produces, designs, tests, manufactures, fabricates, and develops, and determining whether anything falls within the definition of a "critical technology" pursuant to 31 CFR 801.204.
If a U.S. business produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies, the next step is to determine whether the U.S. business utilizes any of those critical technologies

[2] The term "any involvement" does not mean that the foreign person must have final decision-making authority. It captures situations in which the investment gives the foreign person, among other things, any of the following with respect to decision-making regarding the use, development, acquisition, or release of critical technology: the right to consult with or provide advice to a decision-maker; special approval or veto rights; the right or ability to participate on a committee with decision-making authority; the right to have direct access to directors, officers, managers, and other employees engaged in or with the ability to make decisions; or the right to appoint officers or employees who have involvement of the type listed above.

[3] The term "substantive decision-making" as it relates to the use, development, acquisition, or release of a critical technology may include, for example, decisions regarding the following: licensing; pricing, sales, and specific contracts; supply arrangements; corporate strategy and business development; research and product development, including budget allocation; manufacturing locations; access to such technology; the storage or protection of such technology; appointment or removal of personnel or management with operational oversight; or strategic partnerships. As a general matter, substantive decision-making for purposes of 31 CFR 801.209(c) does not include strictly administrative decisions.

in connection with its activities in one or more pilot program industries. If so, the U.S. business is a pilot program U.S. business.

If not, the final step is to determine whether one or more of the critical technologies produced, designed, tested, manufactured, fabricated, or developed by the U.S. business is designed by the U.S. business specifically for use in one or more pilot program industries, irrespective of whether such use is by the U.S. business itself or by another person. If so, the U.S. business is a pilot program U.S. business.

Notably, the definition of pilot program U.S. business only includes companies involved in various stages of development of relevant critical technologies. It does not extend to companies in pilot program industries that merely use those critical technologies.

4. If a transaction falls within the scope of the pilot program, how should parties determine whether to submit a declaration versus a written notice?

The pilot program regulations require that parties to a pilot program covered transaction submit a declaration to CFIUS. Parties may elect, however, to submit a full written notice instead of a declaration. Parties will need to consider at the outset whether to submit a declaration or a full written notice based on the complexity of the transaction, timing considerations, and other relevant factors. A full written notice may be more appropriate than a declaration when the parties believe CFIUS may require more extensive information to analyze potential national security risks. With respect to timing, parties should consider the likelihood that CFIUS will be able to conclude action under Section 721 in the 30 days allotted for assessing a declaration. Because CFIUS has the option of responding to a declaration by requesting that the parties file a written notice, there may be instances in which parties would save time overall by filing a written notice at the outset.

5. Under the pilot program, what information is required in a declaration and a notice?

A declaration is intended to be an abbreviated way of informing CFIUS of a transaction and generally should not exceed five pages in length. The following basic information about a pilot program covered transaction is requested in a declaration:

- a brief description of the transaction and its structure, the voting interest acquired, the economic interest acquired, the total transaction value, the expected closing date and all sources of financing for the transaction;
- a stipulation as to whether the transaction (i) is a pilot program covered transaction, and (ii) could result in control of a pilot program U.S. business by a foreign person, or is a foreign government-controlled transaction;
- an explanation of what access or rights the foreign person will acquire with respect to the pilot program U.S. business;
- business information and activity related to the pilot program U.S. business (including geographic coordinates and U.S. government contracts, grants and funding);
- a statement as to which critical technologies are involved, including whether they are controlled under the EAR or ITAR;
- information related to the foreign person’s parent companies;
- whether the parties have been party to another notified transaction; and

- whether the parties to the transaction (or the foreign parent or subsidiaries) have been convicted of a crime in the last ten years.

If parties elect to file a notice instead of a mandatory declaration, the following information is requested (in addition to the content required for a notice under the existing CFIUS regulations):

- a stipulation as to whether the transaction is a pilot program covered transaction;
- an explanation of what access or rights the foreign person will acquire with respect to the pilot program U.S. business; and
- a statement as to which critical technologies are involved, including whether they are controlled under the EAR or ITAR.

5. What is a stipulation and what is the value of a stipulation?

The interim regulations permit parties to stipulate in a CFIUS declaration or notice that a transaction is subject to CFIUS jurisdiction and that the foreign party is a foreign government-controlled entity. A stipulation could expedite review and action by CFIUS because it may streamline certain aspects of CFIUS's review. It also may result in fewer follow-up questions from CFIUS. In the case of a pilot program covered transaction filed through a notice, stipulating control will reduce certain information requirements. FIRRMA contemplates such stipulations as a condition for limiting to 10 business days the amount of time CFIUS could take to comment on draft notices and accept formal notices, but the interim regulations do not include such time limits.

6. Is there an exemption for certain investment fund investments?

Paralleling FIRRMA, the new interim regulations recognize that certain investment funds may include foreign investors whose interest and involvement in a target U.S. business may be sufficiently limited to refute the possibility of a national security risk arising from the foreign investment. Thus, under the new regulations, there is an exemption from the definition of "pilot program covered transaction" for certain indirect investments in "pilot program industries" by a foreign person through an investment fund even if the foreign person sits on an advisory board or committee of the fund. Specifically, such an indirect investment is not a "pilot program covered investment" with respect to the foreign person if:

(1) the fund is managed exclusively by a general partner, a managing member or an equivalent and that manager is not the foreign person;

(2) the advisory board or committee does not have the ability to approve, disapprove or otherwise control:

  a. investment decisions of the investment fund; or

  b. decisions made by the general partner, managing member or equivalent related to entities in which the investment fund is invested;

(3) the foreign person does not otherwise have the ability to control the investment fund, including the authority:

  a. to approve, disapprove, or otherwise control investment decisions of the investment fund;

  b. to approve, disapprove, or otherwise control decisions made by the general partner, managing member or equivalent related to entities in which the investment fund is invested; or

c. to unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member, or equivalent; and

(4) the foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee.

The interim regulations also provide, for purposes of the decision-making referred to in paragraphs (2) and (3) above, that a waiver of a potential conflict of interest, a waiver of an allocation limitation or a similar activity (as applicable to a transaction pursuant to the terms of an agreement governing an investment fund) will not be considered to constitute control of investment decisions of the investment fund or decisions relating to entities in which the investment fund is invested. However, the regulations also provide that CFIUS may, in "extraordinary circumstances," consider such a waiver to constitute control of such decisions. It therefore would pose risk to rest a decision not to file a declaration on the understanding that such a waiver will not constitute such control.

APPENDIX: PILOT PROGRAM U.S. INDUSTRIES

The "pilot program industries" under the CFIUS pilot program are:

1. **Aircraft Manufacturing**, NAICS Code: 336411
2. **Aircraft Engine and Engine Parts Manufacturing**, NAICS Code: 336412
3. **Alumina Refining and Primary Aluminum Production**, NAICS Code: 331313
4. **Ball and Roller Bearing Manufacturing**, NAICS Code: 332991
5. **Computer Storage Device Manufacturing**, NAICS Code: 334112
6. **Electronic Computer Manufacturing**, NAICS Code: 334111
7. **Guided Missile and Space Vehicle Manufacturing**, NAICS Code: 336414
8. **Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing,** NAICS Code: 336415
9. **Military Armored Vehicle, Tank, and Tank Component Manufacturing**, NAICS Code: 336992
10. **Nuclear Electric Power Generation**, NAICS Code: 221113
11. **Optical Instrument and Lens Manufacturing**, NAICS Code: 333314
12. **Other Basic Inorganic Chemical Manufacturing**, NAICS Code: 325180
13. **Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing**, NAICS Code: 336419
14. **Petrochemical Manufacturing**, NAICS Code: 325110
15. **Powder Metallurgy Part Manufacturing**, NAICS Code: 332117
16. **Power, Distribution, and Specialty Transformer Manufacturing**, NAICS Code: 335311
17. **Primary Battery Manufacturing**, NAICS Code: 335912

18. **Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing**, NAICS Code: 334220
19. **Research and Development in Nanotechnology**, NAICS Code: 541713
20. **Research and Development in Biotechnology (except Nanobiotechnology)**, NAICS Code: 541714
21. **Secondary Smelting and Alloying of Aluminum**, NAICS Code: 331314
22. **Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing**, NAICS Code: 334511
23. **Semiconductor and Related Device Manufacturing**, NAICS Code: 334413
24. **Semiconductor Machinery Manufacturing**, NAICS Code: 333242
25. **Storage Battery Manufacturing**, NAICS Code: 335911
26. **Telephone Apparatus Manufacturing**, NAICS Code: 334210
27. **Turbine and Turbine Generator Set Units Manufacturing**, NAICS Code: 333611

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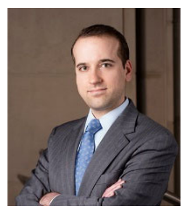

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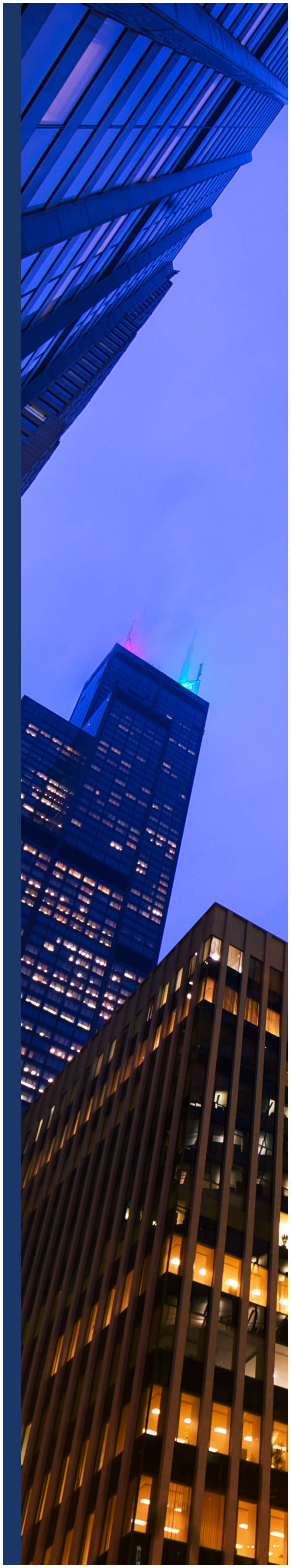
SIGNIFICANT 2018 DECISIONS AFFECTING PRIVATE COMPANY M&A

Arnold & Porter



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March 2019

Significant 2018 Decisions Affecting Private Company M&A

By Nicholas O'Keefe, Edward A. Deibert, Jonathan E. Green, Ronald R. Levine, II, Aaron F. Miner, Brandon J. Hauver, Nate Klein, Evan Leitch, Carlyn S. Williams

The following compilation is our fifth annual review of significant state court decisions relevant for private company M&A transactions and related governance matters and disputes. The summary includes the landmark *Akorn v. Fresenius decision*, which is the first Delaware M&A decision to uphold a buyer's termination right on the basis of an MAE. A few of the decisions concern drafting points, a few concern overall deal process and planning points, and two of the decisions concerned fiduciary duty breaches in contested situations (one was a public company decision that has relevance to the private M&A context).

Akorn, Inc. v. Fresenius Kabi AG, 2018 WL 4719347 (Del. Ch. Oct. 01, 2018), aff'd, 198 A.3d 724 (Del. 2018)

Delaware Court of Chancery provides important interpretive guidance on the meaning of material adverse effect (MAE) clauses and is the first Delaware decision to hold that an acquirer was justified in terminating a merger agreement as a result of the occurrence of an MAE.

Facts

Akorn v. Fresenius is a major decision regarding MAEs in the M&A context, and builds on prior guidance of Delaware courts issued in *IBP* and *Hexion*.[1] *Akorn* involved the proposed acquisition of Akorn, Inc. (Akorn), a generics pharmaceutical company, by Fresenius Kabi AG (Fresenius), for $34 a share pursuant to a reverse triangular merger. The deal was signed on April 24, 2017, and had a drop dead date of April 24, 2018 (the Outside Date). At the time of announcing the deal, Akorn reaffirmed its full year guidance for 2017. Akorn's financial results for the second quarter of 2017 declined precipitously, which Akorn attributed to unexpected competition and loss of a key customer. Akorn's financial results continued to deteriorate in the third quarter of 2017. In October and November 2017, Fresenius received two anonymous whistleblower letters containing allegations about Akorn's product development process and quality compliance programs failing to comply with FDA regulations. Invoking its information access rights under the merger agreement, Fresenius conducted an investigation that uncovered "serious and pervasive data integrity problems," which called into question whether Akorn's representations and warranties under the merger agreement were sufficiently inaccurate as to reasonably be expected to result in a MAE. In a meeting with the FDA in March 2018, Akorn understated its regulatory issues and overstated its remedial efforts. Akorn's financial performance continued to deteriorate throughout this time.

On April 22, 2018, Fresenius delivered notice that it was terminating the merger agreement on two grounds: (i) an uncurable breach of Akorn's regulatory representations and warranties, which gave rise to an MAE, and (ii) an uncurable breach of Akorn's pre-closing covenants. Fresenius also alleged that the stand-alone MAE closing condition was not satisfied. Akorn filed suit, seeking a decree of specific performance to compel Fresenius to close. Fresenius filed a

[1] *See In re IBP, Inc. S'h'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001); *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008).

counterclaim, seeking a declaration that it validly terminated the merger agreement. In a post-trial decision, the Court of Chancery ruled in favor of Fresenius, holding that it validly terminated the merger on both of the two grounds that it invoked, and that Fresenius properly relied on the fact that Akorn had suffered an MAE in refusing to close (although this did not give rise to a termination right under the merger agreement). The Delaware Supreme Court affirmed the Court of Chancery's decision.

Key Merger Agreement Provisions

Section 6.02 of the merger agreement set forth Fresenius' conditions to closing. Section 6.02(a)(ii) set forth the Akorn representation and warranty bring-down, and provided that Akorn's general representations and warranties must be true and correct (disregarding materiality and MAE qualifiers) as of the merger agreement date and as of the closing date except where the failure to be true and correct would not, individually or in the aggregate, reasonably be expected to have an MAE (the Bring-Down Condition). Section 6.02(b) provided that Akorn shall have complied with or performed in all material respects its obligations required to be complied with or performed by it prior to the effective time of the merger (the Covenant Compliance Condition). Section 6.02(c) provided that there shall not have occurred or be continuing an MAE (the General MAE Condition). The failure of the Bring-Down Condition and the Covenant Compliance Condition gave Fresenius a termination right if the failure was incapable of being cured by the Outside Date, so long as Fresenius was not then in material breach of its representations, warranties, covenants or agreements under the merger agreement.

Failure of the General MAE Condition

Fresenius argued that it was not obligated to close because Akorn had suffered an MAE. In considering whether this General MAE Condition was satisfied, the Court of Chancery considered the structure and rationale of a typical MAE provision. The Court of Chancery noted that the typical MAE clause, through the basic provision and numerous exceptions, allocates industry (or systemic) risk to the buyer and company-specific risks on the seller. Relying on *Hexion*, the Court of Chancery noted that for a buyer to satisfy the heavy burden it faces when demonstrating the existence of an MAE, the important consideration is whether the adverse change in the target's business "is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months." A decline in company performance should be evaluated against the company's results during the same quarter of the prior year. The Court of Chancery noted that in *Hexion*, a 3% decline in 2007 EBITDA from the prior year, and projected 7% (or 11% using conservative projections) decline in EBITDA for the next year, did not give rise to an MAE. The Court of Chancery noted that one treatise found that most courts required a decrease in profit of at least 40% in order to find an MAE. In dictum in a prior decision, Chancellor Allen noted that an earnings decline of more than 50% over two quarters would probably constitute an MAE.[2] In *IBP*, a 64% drop in quarterly earnings was found not to give rise to an MAE. However, in that case, then Vice Chancellor Strine noted it was a close call, and buyer's arguments were undermined by buyer's failure to provide expert evidence.

Financial Performance Downturn Constituted an MAE

In contrast to *IBP*, the Court of Chancery found that Fresenius had submitted credible and persuasive expert testimony that Akorn's financial performance had declined materially since the signing of the Merger Agreeent and that the underlying causes of the decline were durationally significant. The court noted that year-over-year declines in quarterly revenue for each quarter from the second quarter 2017 until the first quarter 2018, and in annual revenue for fiscal year 2017, ranged from 25% to 34%. Declines in operating income for the same periods ranged from 84% to 292%, and declines in earnings per share for the same periods ranged from 96% to 300%. Full year EBITDA declined 86%, and full-year

[2] *Raskin v. Birmingham Steel Corp.,* 1990 WL 193326, at *5 (Del. Ch. 1990).

adjusted EBITDA declined 51%. The Court of Chancery noted that Akorn's dramatic fall in performance during 2017 was a reversal of the yearly growth it experienced during the five year period ended in 2016. The Court of Chancery found that the downturn in performance was durationally significant because it had persisted for a full year and showed no sign of ceasing. Management had attributed the performance decline to factors such as new market entrants and loss of a key contract, which the Court of Chancery found created a situation that was likely to persist. The Court of Chancery noted that analysts had slashed estimates of 2018, 2019 and 2020 EBITDA by more than 62.6%, 63.9% and 66.9%, respectively, between the date of signing the merger agreement and the closing date, and had only decreased forward EBITDA estimates for peer companies by 11%, 15.3% and 15%, respectively. The Court of Chancery held that this was strong evidence of an MAE. The Court of Chancery rejected Akorn's argument that the decline in performance should be measured not against its performance as a standalone entity, but should also factor in the synergies to Fresenius. In looking at the MAE definition, which referenced a material adverse effect with respect to Akorn and its subsidiaries and carved out the effect of the consummation of the merger, the Court of Chancery held that the analysis should be based on the performance of Akorn as a stand-alone company.

MAE Exceptions Did Not Apply

Having found that Akorn had suffered a general MAE, the Court of Chancery considered whether any of the exceptions to the MAE applied. Akorn argued that its performance deterioration was due to known "industry headwinds," such as a consolidation of buyer power leading to drug price reductions, the FDA's efforts to approve generic drugs, and legislative attempts to reduce drug prices. The Court of Chancery noted that while industry risks were allocated to Fresenius under the MAE definition, the risk allocation reverted to Akorn if the industry headwinds had a disproportionate effect on Akorn relative to other industry participants. Rejecting Akorn's argument that an exception applied, the Court of Chancery noted that the primary drivers of Akorn's bad performance were new market entrants and loss of a key contract, which were specific to Akorn. But even if you viewed them as industry effects, they disproportionately impacted Akorn relative to other industry participants.

Fresenius did Not Assume the Risk Through Industry Knowledge

Relying on language in *IBP* that MAEs protect against unknown risks, Akorn argued that Fresenius could not claim an MAE based on risks that it learned of in due diligence or was on notice of because of industry knowledge. Rejecting Akorn's argument, the Court of Chancery noted that the argument would introduce a tort-like concept of assumption of the risk, and run counter to Delaware courts' promotion of freedom of contract.

The Court of Chancery distinguished IBP on several grounds. First, the Court of Chancery noted that the MAE in *IBP* did not contain lengthy exclusions, and neither *IBP* nor *Hexion* should be viewed as setting forth rules that apply to all MAEs, including that in *Akorn*. Second, while the analyses in *IBP* and *Hexion* were framed in terms of known versus unknown risks, both cases involved buyers being unable to rely on consequences of widely known systemic risks. *IBP* involved cyclical effects in the meat industry, and *Hexion* involved macroeconomic challenges, such as increases in crude oil and natural gas prices and changes in foreign exchange rates. Thus, both decisions should properly be viewed as consistent with the view that buyers cannot invoke MAEs for known systemic risks, which is different from the situation in *Akorn*. Third, even if *IBP* and *Hexion* could be read as applying a blanket rule that turns on known versus unknown risks, the analysis would not apply in Akorn, because the events that gave rise to the bad performance were unanticipated.

Failure of the Bring-Down Condition

One of Fresenius' bases for terminating the merger agreement was that the Bring-Down Condition was not satisfied because of the inaccuracy of Akorn's representations in Section 3.18 of the merger agreement relating to regulatory compliance. For the Bring-Down Condition not to be satisfied, Fresenius would have to show that the difference between the actual condition of Akorn and the condition as represented was great enough that it would reasonably be expected to result in an MAE. The Court of Chancery held that the "reasonably be expected" standard was an objective one that required a qualitative and quantitative analysis.

Qualitative Analysis

The Court of Chancery held that the "overwhelming evidence of widespread regulatory violations and pervasive compliance problems at Akorn" strongly supported a finding of an MAE. The Court of Chancery noted that Akorn had "pervasive data integrity and compliance problems" that prevented it from meeting FDA data integrity requirements. The Court of Chancery invoked numerous examples of Akorn's failures. For example, one of Akorn's own consultants testified that data integrity failures were so bad he would not expect to see them "at a company that made Styrofoam cups," and that its integrity issues were among the three worst of the more than120 pharmaceutical companies he had assessed. The Court of Chancery noted that evidence showed that Akorn was aware of the issues but ignored them. After the merger agreement was signed, the head of Akorn's quality function exacerbated the problem by submitting false data to the FDA. Akorn also submitted misleading information to the FDA regarding its efforts to investigate problems. Counsel retained by Fresenius to investigate the problems also identified "serious fundamental flaws" in Akorn's management of data. An expert witness retained by Fresenius also tested that he had "rarely seen integrity issues that exist at the scope and scale we see" at Akorn.

Quantitative Analysis

The Court of Chancery held that the quantitative aspects of the MAE analysis also supported the finding that Akorn's regulatory issues would reasonably be expected to result in an MAE. Akorn estimated expenses of $44 million to remediate its data integrity problems, with no other impact on valuation. Fresenius estimated remediation expenses of $254 million, plus a valuation hit of up to $1.9 billion due to suspension of products being marketed and delays in new products. The Court of Chancery found that the valuation impact would be somewhere between the two, at approximately $900 million. The court of Chancery compared this to the standalone valuation of Akorn when the merger agreement was signed of approximately $3.9 billion, and arrived at a valuation decrease of approximately 21%.

Looking at various anecdotal sources, the Court of Chancery held that a 21% valuation decrease satisfied the test of being "material when viewed from the longer-term perspective of a reasonable acquiror." The court first noted that during diligence and negotiation of the transaction, Fresenius was willing to close despite identifying a high risk of potential exposures of approximately $200 million in value, and that the valuation impact of Akorn's regulatory failures was four to five times greater. The Court also noted that a bear market is deemed to occur when stock prices fall at least 20%, and that one unpublished study found that the average negotiated price reduction following the occurrence of an MAE is 15%. The Court of Chancery considered academic studies and market practice and observed that upper and lower bounds for collars generally fall within 10% to 20% of deal consideration at signing, which indicated that parties viewed a 10% value change as material. The Court of Chancery noted a 2011 law firm study that found that median reverse termination fees equaled 6.36% of transaction value.

Fresenius' Knowledge of Regulatory Risks Did Not Foreclose an MAE Finding

The Court of Chancery rejected Akorn's argument that Fresenius could not claim the existence of a regulatory MAE because it knew about the risk of potential issues when it signed the merger agreement. The Court of Chancery noted that Delaware cases have held that "a breach of contract claim is not dependent on a showing of justifiable reliance."[3] Allowing

[3] Citing *Cobalt Operating, LLC v. James Crystal Enterprises, LLC*, 2007 WL 2142926 (Del. Ch. July 20, 2007), *aff'd*, 945 A.2d 594 (Del. 2008).

parties to allocate risk under the acquisition agreement serves the important purpose of not forcing acquirors to undergo extensive and costly due diligence.

Akorn argued, relying again on *IBP*, that the MAE provision changes the analysis because it should be understood as backstop protection from unknown events. Rejecting Akorn's argument, the Court of Chancery reasoned that adding an MAE qualifier does not change the nature of the representation, but merely addresses the permissible degree of deviation from the representation before the representation is deemed inaccurate. Whether the buyer had concerns about regulatory compliance matters was irrelevant—the mere existence of the representation demonstrates some level of concern by the buyer. But what is important is how the parties allocated the risk of inaccuracy of the representation under the acquisition agreement. Akorn's approach would turn an MAE-qualified representation into an expansive knowledge-based qualification of the representations based on everything the buyer knew or should have known. In dictum, the Court of Chancery noted that its reasoning did not necessarily mean that a buyer who knew about a specific risk should be permitted to close and then sue for damages, because that has different public policy implications.

The Court of Chancery noted that even if you accepted Akorn's argument, while Fresenius did identify regulatory risks in diligence, it did not know about Akorn's data integrity issues, and could not have known about the actions that Akorn took after signing the merger agreement that increased the risk further.

The Court of Chancery then considered whether the regulatory compliance representations were capable of being cured prior to the Outside Date. The Court of Chancery held that no such cure was possible, noting that Akorn's own witnesses believed that the regulatory failures would take three years to cure.

Failure of the Covenant Compliance Condition

A second basis for Fresenius' termination of the merger agreement was that Akorn breached its covenant to use commercially reasonable efforts to carry on its business in all material respects in the ordinary course of business, and that such breach could not be cured prior to the Outside Date. The Court of Chancery first considered Akorn's argument that the "all material respects" language adopted the common law standard for material breach of contract. Rejecting the argument, the Court of Chancery held instead that it required a less onerous standard, akin to that used to assess materiality for purposes of disclosure, which it described as a "substantial likelihood that the fact of breach would have been viewed by the reasonable investor as having altered the total mix of information."

The Court of Chancery next considered the "commercially reasonable efforts" language. The Court of Chancery noted that while practitioners generally consider it as the fourth in a hierarchy of five efforts standards, ranging from "good faith efforts" to "best efforts," case law has interpreted "commercially reasonable," "reasonable best," and "best" similarly. The Court of Chancery held that it required Akorn to "take all reasonable steps" to maintain operations in the ordinary course of business.

The Court of Chancery framed the test whether Akorn had taken all reasonable steps to maintain operations in the ordinary course of business as an objective one, as opposed to considering what historically constituted the ordinary course of business for Akorn. The Court of Chancery held that Akorn failed to comply with this standard in several respects, including through conducting regular audits and taking steps to remediate deficiencies, failing to maintain adequate data integrity systems, submitting fabricated regulatory filings to the FDA, and failing to conduct responsible and credible investigations when provided with the two whistleblower letters. The Court of Chancery held that Akorn's breach of the ordinary course covenant was material, because the record indicated that Fresenius would not have agreed to buy Akorn if it had known that Akorn would fail to comply with the ordinary course covenant in the way that it did. The Court of Chancery held that the Covenant Compliance Condition could not have been cured by the Outside Date, and thus Fresenius was justified in invoking it as a basis for termination.

No Fresenius Material Breach

The Court of Chancery considered whether Fresenius was in material breach of the merger agreement, which would have barred it from exercising its termination right on both of the two grounds. The court first considered whether Fresenius breached its covenant to use reasonable best efforts to close. The court noted that this did not impose an obligation to merge at all costs, but should be considered in light of Akorn's representations, and Fresenius' conditions and termination rights under the merger agreement. The court held that the analysis required a consideration of whether Fresenius "(i) had reasonable grounds to take the action it did and (ii) sought to address problems with its counterparty." In finding that Fresenius did not breach its reasonable best efforts covenant, the Court of Chancery found that Fresenius was justified in undertaking the investigation of Akorn that it did after learning of regulatory issues and receiving the whistleblower letters. The court held that Fresenius acted reasonably before it decided to terminate the merger agreement, and even offered to extend the Outside Date, which Akorn refused. The court rejected Akorn's efforts to depict Fresenius as having "buyer's remorse," similar to the buyers in *IBP* and *Hexion*, noting "the difference between this case and its forebearers is that the remorse was justified."

The Court of Chancery held that Fresenius breached its covenant regarding efforts required to obtain antitrust approval, but that the breach only lasted for about a week and was not material. Accordingly, Fresenius was able to validly terminate the merger agreement.

Takeaways

Akorn is a major decision that provides guidance on a number of topics, including the following:

MAE Definition: The decision provides guidance on the nature and magnitude of a deterioration in financial performance that is required in order to constitute an MAE. The typical MAE allocates industry/systemic risks to the buyer, so risks that are general industry risks, and that don't disproportionately impact the seller relative to other industry participants, will not trigger an MAE. The deterioration has to be durationally significant, typically over years and not months, and is measured relative to corresponding periods in prior years. In *Akorn*, the deterioration was significant by any measure, and the hurdle is therefore likely to remain very high after this decision.

Buyer's Knowledge: Many practitioners read *IBP* as indicating that MAEs would be evaluated in light of the knowledge that a buyer possessed when entering into the agreement. *Akorn* suggests that is incorrect, and that the buyer in IBP assumed the risks at issue there not because the buyer knew of them, but because they were industry/systemic risks that buyers typically assume under MAE definitions. The *Akorn* decision adopts much more of a pro-contractarian approach, where the court deferred to the parties' risk allocation under the merger agreement, as opposed to reliance on notions of what a buyer knew or should have known at the time of contracting.

Sandbagging: Practitioners typically view Delaware as a pro-sandbagging jurisdiction, which means that buyers are not foreclosed from bringing claims from breach of representations and warranties even if they knew they were inaccurate at signing. The *Akorn* court noted in dictum that while it was pro-contractarian in that it would not inquire into what a buyer knew or should have known for purposes of the closing conditions, different policy considerations apply with respect to claims for breach of representations and warranties. Thus, the court called into question whether Delaware really is a pro-sandbagging jurisdiction. It is worth noting that in an unrelated 2018 decision, Justice Valihura noted that whether Delaware courts permit sandbagging is an unresolved issue, and Chief Justice Strine cast doubt on whether Delaware courts would permit it.[4]

[4] See *Eagle Force Holdings, LLC v. Stanley*, C.A. No. 10803-VCMR (Del. 2018).

MAE Bring-Down: The *Akorn* decision provided guidance on how to evaluate whether inaccuracies of representations would reasonably be expected to result in an MAE. Given its prospective nature, this is different from the analysis of a general MAE, which is more of a financial analysis. The MAE Bring-Down analysis involves a qualitative and quantitative review of the inaccuracy. The qualitative analysis in *Akorn* involved particularly egregious facts which are unlikely to be present in many situations. The quantitative analysis suggests that a valuation decrease of 20% is likely to be sufficient to support an argument that the representation inaccuracy gave rise to an MAE. A decrease of between 10% and 20% is likely to fall in a grey area.

Interim Operating Covenant: The decision provides interpretive guidance on covenants to use commercially reasonable efforts to operate the business in the ordinary course between signing and closing. As in several other decisions, the *Akorn* court minimized the significance of the difference among the various efforts standards, such as “commercially reasonable efforts,” “best efforts,” and “reasonable best efforts.” The applicable test was whether Akorn had taken “all reasonable steps” to maintain operations in the ordinary courts of business. Practitioners should note that this was an objective standard, which involved a comparison of what Akorn did against what a typical company in its industry would do. Thus, implicitly, Akorn would have been unable to rely on its conduct prior to the merger agreement signing date as setting a benchmark.

Reasonable Best Efforts Covenant: For deal parties concerned about a potential condition failure that may give rise to that party having a termination right, the decision provides useful guidance on how the party should conduct itself in order to avoid a breach of its obligation to use the requisite degree of efforts to close. The *Akorn* court held that the applicable test was whether the applicable party “(i) had reasonable grounds to take the action it did and (ii) sought to address problems with its counterparty.” Parties are not obligated to close at all costs, but should continue to push forward in light of their contractual rights to investigate circumstances giving rise to condition failures and termination rights. As was the case in Akorn, a buyer’s compliance with its efforts obligations is typically a prerequisite to the buyer being able to invoke a termination right. The consequences of failing to comply can therefore be much more significant than simply giving rise to a damages claim for breach of contract.

Delaware’s Pro-contractarian Approach: Throughout the decision, the Court of Chancery advocated following the language and structure of the merger agreement and eschewed Akorn’s attempts to impart bright line rules that may significantly change the contractually agreed allocation of risk. The decision therefore serves as a useful reminder that if an issue or interpretation is significant to a party, the party should draft appropriate language in the acquisition agreement. For example, if a target company wants the acquiror to assume known risks, it should expressly carve them out from the MAE definition.

Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 2018 De Ch Lexis 550 (Del. Ch. Dec. 03, 2018)

Delaware Chancery Court held that fraud carve-out from indemnity caps only applied to indemnity claims against CEO who committed fraud, and not to indemnity claims against other stockholders.

Great Hill involved a post-trial decision in a fraud action brought by affiliates of a private equity fund, Great Hill, in connection with their acquisition of a FinTech company, Plimus, Inc., which was controlled by affiliates of another private equity fund (SIG).[5] Following Plimus' disappointing performance after closing, plaintiffs brought claims against a number of parties, including SIG and the Plimus CEO, alleging breaches of representations and warranties, and fraud and fraudulent inducement. In considering plaintiffs' arguments that the fraud exception from the indemnification cap should apply with respect to all of the defendants, the court held that the fraud exception only applied with respect to claims against the CEO, because he was the only defendant who committed fraud.

Fraud Claims

In connection with plaintiffs' fraud and fraudulent inducement claims, the Court considered four alleged instances of fraud. The court found that only plaintiffs' allegations relating to Plimus' contractual relationship with a payment processor, PayPal, gave rise to fraud. The PayPal relationship was an important one for Plimus. The relationship was in jeopardy when the merger agreement relating to the Plimus acquisition was signed, and PayPal terminated the relationship shortly after the merger closed. Plaintiffs alleged that the failure to disclose and/or the active concealment of PayPal's notices of violations and threats to terminate its agreement with Plimus, among other things, gave rise to fraudulent misrepresentations under the merger agreement. The court agreed, but held that the CEO was the only defendant who was liable for fraud because he was the only person who had actual knowledge of the falsity of the representations.

Indemnification Cap

The plaintiffs also brought indemnification claims against certain of the defendants (the Indemnification Defendants), based on alleged breaches of representations and warranties under the merger agreement. The court held that various PayPal fines and termination threats gave rise to breaches of representation relating to compliance with the bylaws and operating rules of card systems, and to relationships with suppliers.

The Merger Agreement contained an indemnification cap, which limited defendants' liability for breach of representations and warranties to their pro rata share of the escrow funds. But it made the indemnification cap inapplicable "in the case of fraud or intentional misrepresentation (for which no limitations set forth herein shall be applicable)." Plaintiffs claimed that the fraud exception applied with respect to all Indemnification Defendants, and not just those who committed fraud. The court disagreed, holding that the indemnification provisions provided "a thoughtful, bargained-for liability scheme" for stockholders subject to indemnification obligations. The court noted that these stockholders benefited from having liability limited to the escrow, and in exchange the buyer benefited from a pro-sandbagging provision elsewhere in the Merger Agreement, which provided that the buyer would be indemnified regardless of pre-contractual notice of the falsity of the representations and warranties.

The court reasoned that plaintiffs' interpretation, in the case of fraud, would lead to uncapped liability against selling stockholders, without regard to fault. Given the pro-sandbagging language, this could even be the case where the buyer knew of the misrepresentation before signing the merger agreement. The court found this interpretation to be unreasonable, and inconsistent with the language of the merger agreement and the liability scheme the parties created.

Takeaways

The court's decision has some equitable appeal from the perspective of a selling stockholder that "would have limited or no opportunity to verify the representations and warranties personally" and, therefore, should not have uncapped liability for another stockholder's fraud. Nevertheless, the decision is arguably in tension with *EMSI Acquisition, Inc. v. Contrarian*

[5] A 2013 court decision stemming from the same dispute attracted a lot of attention, and led to deal practitioners including provisions in deal agreements allocating ownership of legal privileges between deal parties. *See Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, C.A. No. 7906 (Del. Ch. Nov. 15, 2013).

Funds, LLC, 2017 WL 1732369 (Del. Ch. May 3, 2017), where, in refusing to grant a motion to dismiss, the *EMSI* court found plausible buyer's argument that a fraud exception applied, regardless of whether the fraud was that of the selling stockholders or of management. The *Great Hill* court, in reaching a different result, relied in part on the presence of a pro-sandbagging provision, which the Court noted could have the harsh result of Indemnification Defendants having uncapped exposure for fraud committed by management of which they were unaware but the buyer was aware prior to signing the merger agreement.

The takeaway for buyers is that they should include express language in the indemnity section that makes clear that the fraud exception to indemnity caps applies not only to claims against a tortfeasor, but also to all claims against indemnifying parties that are based on fraud committed by others. For example, the language "except in the case of fraud or intentional misrepresentation" could be modified to read: "except in the case of fraud or intentional misrepresentation (whether by management or any indemnifying party)." Sellers, on the other hand, should try to include language that makes clear that the fraud exception applies only with respect to claims against the tortfeasor. For example, the fraud carve-out could provide: "except in the case of fraud or intentional misrepresentation by the indemnifying party (which exception shall not apply with respect to indemnity claims against a person who has not committed fraud or an intentional misrepresentation)."

QC Holdings, Inc. v. Allconnect, Inc., C.A. No. 2017-0715-JTL (Del. Ch. 2018)

Company obligation to make payment for put shares survived acquisition of company in reverse triangular merger.

Background

The decision involved a motion for summary judgment by QC Holdings Inc. (QC Holdings), a former stockholder of Allconnect Inc. (Allconnect), in an action against Allconnect seeking payment of the $5 million put price arising from QC Holdings' exercise of a put option requiring Allconnect to redeem 18,604,071 shares of common stock held by QC Holdings.

The put option was originally entered into in connection with Allconnect's acquisition of substantially all of QC Holdings' assets in October 2013. The put agreement specified that (1) Allconnect's obligation to repurchase the put shares was contingent on Allconnect having sufficient funds legally available in accordance with Delaware law, and (2) Allconnect had no obligation to pay the put price as long as Allconnect had any senior indebtedness outstanding. In addition, though QC Holdings was permitted to exercise its put right during the 60-day period beginning November 15, 2015, Allconnect was not obligated to pay the put price until November 15, 2016.

Even though Allconnect had negative cashflow and outstanding senior indebtedness, QC Holdings exercised its put right on November 16, 2015. In doing so, QC Holdings complied with the agreement's requirements that it deliver a written exercise notice, an assignment separate from certificate, and the original stock certificate for the put shares. Allconnect confirmed receipt of the above. By letter dated November 2, 2016, Allconnect informed QC Holdings that it would not pay the put price on November 15, 2016 due to its outstanding senior indebtedness.

In September of 2017, Allconnect was acquired by New Imagitas Inc. (Imagitas) in a reverse triangular merger. As consideration, Imagitas paid $83 million, of which $10.8 million paid off Allconnect's debt, $67 million was paid to Allconnect's stockholders (going largely to preferred stockholders, with common stockholders receiving only 2 cents per share), and $5.1 million was used to establish an escrow fund to address the QC Holdings put claim. On October 9, 2017, QC Holdings filed suit to recover the put price and its legal fees.

The Court's Analysis

The court first considered Allconnect's argument that Allconnect's obligation to pay the put price existed only on November 15, 2016, and terminated if Allconnect was not able to pay on that date. While the court found that some language in the put agreement supported Allconnect's argument, the court rejected Allconnect's interpretation, holding that it would work a forfeiture and thus could not prevail unless supported by unambiguous language. The court noted that the put agreement did not expressly state that the obligation to pay the put price terminated, or that Allconnect had no further obligation to pay if it was unable to do so on November 15, 2016. Instead, the court noted use of words in the put agreement such as "to the extent that" and "for so long as," which implied a continuing obligation to pay. The court viewed it as "commercially irrational" for QC Holdings to agree to the type of one-day payment obligation described by Allconnect, particularly given that Allconnect could manipulate it by taking on senior indebtedness. The court noted that wording in Allconnect's letter of November 2, 2016, and the fact that Allconnect carried the $5 million redemption obligation on its books in 2016 and 2017, also supported the view that the obligation to pay the put price was ongoing.

The court then considered QC Holdings' argument that Allconnect was obligated to pay the put price as soon as the senior indebtedness was repaid, which occurred immediately prior to the effective time of the merger. QC Holdings argued that the merger consideration created sufficient funds legally available for such payment. The court rejected this argument, noting that it was inconsistent with a line of Delaware cases that held that a merger effected a transmutation at the stockholder level, and thus the merger consideration did not represent funds available for the target company to use.

For the court, the crucial question was whether the put shares remained outstanding at the time of the merger or had been transferred to Allconnect upon exercise of the put option. If the former, the shares would be cancelled in the merger and QC Holdings would be entitled to receive the merger consideration for them. If the latter, QC Holdings would have a contractual redemption right that survived the merger as an ongoing obligation of the surviving corporation pursuant to Section 259 of the Delaware General Corporation Law (DGCL). Considering applicable provisions of the DGCL and the Uniform Commercial Code, and the actions taken by QC Holdings upon exercise of the put option, the court held that Allconnect acquired title to the shares on exercise of the put option, subject to the obligation to pay the put price. Accordingly, QC Holdings had a contractual claim against Allconnect, which survived the merger.

The court then noted that under the merger agreement, Allconnect designated the escrow funds as legally available to pay the put price. In granting QC Holdings' motion for summary judgment, the court held that QC Holdings was entitled to a decree of specific performance compelling Allconnect to use the escrow funds to fulfill its obligations under the put agreement.

Takeaways

This case illustrates the potentially significant economic disparity, and associated drafting importance, between stockholders retaining their status as stockholders, or becoming creditors, on exercise of a put option. QC Holdings ended up receiving the equivalent of approximately $0.27 per share, instead of the approximately $0.02 per share it would have received if its shares had been cashed out in the merger.

In its decision, the court noted that it was not holding that whenever a stockholder exercises a put right, it loses its status as a stockholder and becomes a creditor. The court noted that it would be possible to draft in a way that made explicit whether the stockholder retained its rights and status as a stockholder, or became a creditor. What was dispositive in this case was that the put agreement required QC Holdings to deliver an endorsed stock certificate, plus an assignment, plus representations regarding the transfer of title. This resulted in QC Holdings becoming a creditor, although its rights to enforce payment were subject to statutory and common law restrictions on redemptions. Parties entering into put agreements may wish to make such treatment express in their put agreements.

Had there not been escrow funds available for payment of the put price, QC Holdings' claim would have been more complicated. Stockholders entering into put agreements should consider expressly providing that the payment obligations become due at the time of a company's sale.

Alarm.com Holdings, Inc. v. ABS Capital Partners Inc., 2018 WL 3006118 (Del. Ch. June 15, 2018), aff'd 2019 De Lexis 53 (Del. Feb. 07, 2019)

Investments made by a private equity sponsor in a business competing with an existing portfolio company's business do not, on their own, constitute a misappropriation of trade secrets, particularly when such investments are permitted by the portfolio company's governing documents.

Background

In *Alarm.com*, plaintiff Alarm.com Holdings Inc. (Alarm) brought suit against defendants ABS Capital Partners Inc., ABS Partners V LLC and ABS Partners VII LLC (collectively, ABS) asserting that (1) ABS had misappropriated trade secrets under the Delaware Uniform Trade Secrets Act (DUTSA) and (2) ABS had engaged in common law misappropriation of confidential information. Each of these claims related to ABS's equity investment in Alarm and one of Alarm's competitors and ABS' related board representation on each company's board of directors. The Delaware Court of Chancery dismissed each claim for failure to state a claim pursuant to Court of Chancery Rule 12(b)(6), finding that (1) based on the facts presented by Alarm, and in light of the documents executed by Alarm and ABS, it was not reasonably conceivable that ABS engaged in misappropriation under DUTSA, and (2) DUTSA preempted Alarm's common law claim.

In 2008, ABS Capital Partners, Inc., a private equity firm, began exploring a potential investment in Alarm. In connection with its analysis of Alarm, ABS executed a nondisclosure agreement (2008 NDA) that, while providing for the protection of Alarm's confidential information, expressly provided that, assuming ABS complied with the terms of the 2008 NDA, ABS could invest in competing businesses. After conducting its due diligence, ABS invested in Alarm, acquiring preferred stock carrying 80%of Alarm's then-outstanding voting power. In connection with such investment, ABS and the other stockholders of Alarm executed a stockholders agreement (2009 Stockholders Agreement) providing that ABS could designate three of Alarm's five directors. The 2009 Stockholders Agreement also contemplated that investors (including ABS) could own equity in competing businesses, and excluded ABS from a provision therein that revoked board observation rights from investors owning equity in competing businesses. ABS designated three members of Alarm's board, each of whom participated in board meetings, learned confidential information regarding Alarm and was involved in many of Alarm's major business decisions.

In 2012, Alarm raised additional capital by issuing a new series of preferred stock to new investors, and in connection therewith Alarm adopted a new Amended & Restated Certificate of Incorporation (2012 Charter) and its stockholders executed a new stockholders agreement (2012 Stockholders Agreement), which superseded the 2009 Stockholders Agreement. The 2012 Stockholders Agreement, among other things, increased the size of the Alarm board to seven members and reduced ABS's representation on the board to two members; it also provided for the protection of Alarm's confidential information while including a provision allowing ABS and certain other investors to invest in competing companies so long as such investors do not disclose or use any of Alarm's confidential information in doing so. Further, and specifically highlighted by the Delaware Court of Chancery, the 2012 Charter included a provision authorized by Section 122(17) of the Delaware General Corporation Law (the DGCL), which exempts stockholders such as ABS from any duty not to pursue corporate opportunities that otherwise might arguably belong to Alarm.

In June 2015, Alarm completed an initial public offering, and in connection therewith, the 2012 Stockholders Agreement expired and ABS's preferred shares converted to common stock. One of the directors originally appointed by ABS to the Alarm board continued to serve until resigning in August 2016, and no representative of ABS subsequently held a position with Alarm.

In September 2017, ABS acquired an equity interest in Resolution Products, Inc. (Resolution), a company that directly competes with Alarm, and, in connection therewith, ABS appointed a single member to Resolution's board of directors. The director appointed by ABS to Resolutions' board had not previously served on Alarm's board or held any position with Alarm, and had not observed any board meeting of Alarm.

Complaint and Legal Analysis

Alarm cited ABS's investment in Resolution and its representation on Resolution's board of directors to claim that ABS had either already misappropriated or inevitably will misappropriate trade secrets in violation of DUTSA or, in the absence of any trade secrets, has engaged or inevitably will engage in common law misappropriation of Alarm's confidential information. ABS moved to dismiss Alarm's complaint for failing to state a claim on which relief could be granted.

Upon review, the Delaware Court of Chancery noted that in order to survive ABS's motion to dismiss, Alarm's complaint would have had to plead that (1) a trade secret of Alarm existed, (2) Alarm communicated that trade secret to ABS, (3) the communication was made pursuant to an express or implied understanding that ABS would maintain the secrecy of the information, and (4) the trade secret was then misappropriated, as such term is defined in DUTSA. The court assumed, for the sake of its analysis, that the first three requirements were met and, therefore, Alarm only needed to demonstrate that trade secrets were misappropriated by ABS within the meaning of the term under DUTSA. Under DUTSA, "misappropriation" was defined in relevant part to include an "acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means," which could be demonstrated through circumstantial evidence.

The court found that even under the associated relaxed-pleading standard, Alarm's complaint did not support a reasonably conceivable inference of misappropriation. It also found that Alarm's reliance on ABS's investment in Resolution, made approximately one year after ABS's last representative resigned from the Alarm board, did not support an inference of misappropriation. The court noted that Alarm and ABS had a longstanding understanding that ABS was permitted to invest in competitors. While under the terms of the 2012 Stockholder Agreement ABS was not permitted to "make use of any proprietary or confidential information of the company in connection with such activities," the agreement recognized that an investment by ABS in a competitor of Alarm would not, on its own, violate such confidentiality terms. This understanding was also reflected in other executed agreements by Alarm and ABS over the course of their relationship, beginning with the 2008 NDA and including the 2009 Stockholders Agreement, the 2012 Charter and 2012 Stockholders Agreement.

The court found that fiduciary duty waiver language in Alarm's 2012 Charter further supported its conclusions. The 2012 Charter included an express waiver of any "duty (contractual or otherwise) not to, directly or indirectly, engage in the same or similar business activities or lines of business" as Alarm. The effect of this language was to waive any claim for breach of the duty of loyalty against ABS or its board designees based on either usurpation of corporate opportunity or anticompetitive activity. The court found that the clear intent of this language was "to permit ABS to invest in competing companies like Resolution," and the language would serve as a defense to a breach of fiduciary duty of loyalty claim, should Alarm attempt to bring one in connection with ABS's investment in Resolution. The court reasoned that it would be counterintuitive to permit Alarm to bring its statutory claims under DUTSA, which operates against nonfiduciaries, when comparable fiduciary duty claims would be waived under the 2012 Charter.

The court also dismissed Alarm's common law misappropriation claim on the basis of being preempted under DUTSA.

Takeaways

- Corporations
  - Corporations executing nondisclosure agreements, stockholder agreements or other agreements with investors that include provisions pertaining to the confidentiality of sensitive information, corporate opportunities or the investors' ability to invest in competing businesses should review the terms of such agreements carefully to make sure that they fully understand the ability of their investors under such agreements, and that such terms either adequately safeguard the corporation's sensitive information, or permit the corporation latitude to control disclosure.
  - Corporations should also consider other options for protecting their sensitive information other than labeling such information as trade secrets or as confidential under the terms of an NDA.
- Private Equity Investors
  - Private equity investors should carefully review the terms of any NDA, stockholders agreements or other documents executed with a prospective portfolio company, including the governing documents of such company, in order to make sure that they retain sufficient optionality to deploy capital in other investments as needed. Fiduciary duty/corporate opportunity waivers in charters and stockholder agreements are fairly standard provisions, and serve an important purpose.
  - Private equity investors should also make sure to abide by the terms of any NDA, stockholders agreements or other documents once such documents are executed in order to attempt to avoid any allegations of wrongdoing.
- Co-Investors
  - Co-investors with board representation or observer rights should consider seeking a most-favored-nation clause or otherwise ensuring that they obtain the same ability as other investors in the company to act upon corporate opportunities or otherwise deploy capital in other investments.

Penton Business Media Holdings, LLC v. Informa PLC and Informa USA, Inc., C.A. No. 2017-0847-JTL (Del. Ch. July 9, 2018)

When drafting dispute resolution provisions, parties must be explicit in whether they want a third party to act as an arbitrator or an expert, and the scope of information that third party may consider. When dispute mechanism procedures for another provision of an agreement are incorporated by reference to a section of the agreement, parties should explicitly outline any differences they intend to apply for disputes arising under that section.

Penton involved a motion for judgment on the pleadings in an action in the Delaware Court of Chancery stemming from the acquisition of Penton Business Media Holdings Inc. (Company) from Penton Business Media Holdings LLC (Seller) by Informa PLC and Informa USA Inc. (jointly, the Buyer) in a reverse triangular merger. The merger agreement outlined how pre-closing and post-closing tax benefits should be allocated among the parties. The pre-closing tax benefits provision directed the Buyer to pay the Seller the amount of any refund the Buyer received as a result of tax benefits applied to that period. The post-closing provision directed the Buyer to pay the Seller 40% of any tax benefits the company realized in a post-closing period. In both cases, the provisions incorporated dispute mechanism procedures set forth in the merger agreement for a dispute regarding the purchase price allocation. At issue was whether the parties intended the independent accounting firm charged with resolving a dispute pursuant to the merger agreement to act as an arbitrator or an expert. If an arbitrator, then the accounting firm had the authority to determine the scope of materials available to it for its review of a tax dispute when applying the procedures outlined for an accounting dispute in the merger agreement. This could open the door to information and materials that the parties did not contemplate within the scope of review in order to resolve a dispute. Conversely, if the accounting firm was to act as an expert only, the accounting firm's scope of review was much narrower and the information available to it would be limited to that determined by the court to be permitted by the merger agreement.

After the closing of the transaction, the Buyer delivered to the Seller a proposed tax form offsetting pre-closing liability with $40 million in deductions, which would result in an estimated refund of $600,000. If the deductions had been applied to a post-closing period, in contrast, the Seller would have been entitled to payment of approximately $16 million. The Seller disputed the allocation of the tax benefits to a pre-closing period, citing early iterations of the term sheet for the transaction and the offering circular prepared by the buyer in connection with the rights offering for the transaction as support for its position.

Following the dispute resolution mechanism in the merger agreement, the parties submitted the question of what amount of the tax deductions should be applied to a post-closing period to Ernst & Young (Accounting Firm) for resolution. However, the parties were not able to agree on what information the Accounting Firm could consider when resolving this issue. The Buyer's position was that the Accounting Firm could not consider any information other than what was permitted by the merger agreement, which it argued did not include the drafts of the term sheet and the offering circular. The Seller argued, on the other hand, that the purchase price dispute resolution provision was drafted in order to resolve accounting disputes, but a tax dispute was sufficiently different to require the use of additional outside materials. The Seller argued that the language of the merger agreement applying the dispute resolutions procedures to the pre- and post-closing tax benefit sections allowed for these additional materials to be considered.

Unable to determine the scope of information the Accounting Firm could consider, the parties also disagreed as to the scope of the Accounting Firm's authority. In its suit seeking declaratory judgment, the Seller argued that the Accounting Firm had the ability to determine the information available to it. The Buyer argued that only the court had this authority.

Applicable Language of the Merger Agreement

The pre- and post-closing tax benefit provisions piggybacked on the dispute resolution mechanism in Section 2.8 of the merger agreement that applied to purchase price adjustments. The pre-closing tax benefit provisions specified that the procedures for resolution of a dispute regarding pre-closing tax benefits should be one corresponding to the purchase price dispute resolution mechanism outlined in Section 2.8(b) of the merger agreement. The post-closing tax benefit provisions specified that the general procedures set forth in Section 2.8(b)(ii) shall apply "mutatis mutandis" in order to resolve disputed items between the Buyer and the Seller. Section 2.8(b)(ii) provided for the Accounting Firm to make a determination based solely on the following information:

(i) the definitions and other applicable provisions of this Agreement;

(ii) a single presentation (which presentations shall be limited to the remaining items in dispute set forth in the Proposed Closing Date Calculations and Purchase Price Dispute Notice) submitted by each of [the Buyer] and the [Seller] to the Accounting Firm within fifteen (15) days after the engagement thereof; and

(iii) one written response submitted to the Accounting Firm within ten (10) Business Days after receipt of each such other party's presentation, and not on an independent review.

This section further specified other sources of information the Accounting Firm could not consider:

> The parties agree that no *ex parte* conferences, oral examinations, testimony, depositions, discovery or other form of evidence gathering or hearings shall be conducted or allowed by the Accounting Firm; provided, however, that at the Accounting Firm's request, or as mutually agreed by [the Buyer] and the [Seller], [the Buyer] and the [Seller] may meet with the Accounting Firm so long as Agents of both parties are present.

The merger agreement also specified that in resolving the items in dispute, "the Accounting Firm shall be acting as an accounting expert only and not as an arbitrator and shall not import or take into account usage, custom or other extrinsic factors."

Who Determines the Scope of What an Independent Accounting Firm Can Decide

In analyzing whether the court or the Accounting Firm could decide the scope of information available to the Accounting Firm for its review, the court first asked whether the dispute resolution called for an arbitration or an expert determination.

The court held that while states and federal circuits are split on whether there is a distinction between arbitration and expert determination, Delaware does recognize a distinction between the two, and Delaware courts do not apply arbitral principles to all contractual dispute resolution mechanisms. If the dispute resolution called for an arbitration determination, the doctrines of substantive and procedural arbitrability would govern. Substantive arbitrability relates to the scope of arbitration and applicability to the dispute. Procedural arbitrability encompasses, among other things, resolving what evidence the arbitrator may consider in the scope of its review. Thus, if the dispute resolution called for an arbitration determination, the Accounting Firm could decide the question of what information was available to it. Alternatively, if the dispute mechanism outlined in Section 2.8 of the merger agreement called for an expert determination, it would fall to the court to decide what information could be considered based on the contract language.

In this case, the merger agreement explicitly called for the Accounting Firm to "act as an expert and not as an arbitrator," indicating the parties contemplated a narrow dispute mechanism utilizing the Accounting Firm's technical expertise as an accountant and not an arbitrator. In support of this conclusion, the court referenced a report prepared by the Committee on International Commercial Disputes of the New York Bar Association that recommended parties use this precise language in contracts in order to indicate an expert determination rather than an arbitration. This language alone, though, may not be sufficient. The court indicated it was possible to envision a situation where parties used the "expert not arbitrator" language, but then went on to outline dispute resolution procedures that mimicked arbitration, which could result in a court disregarding the choice of an expert determination. In such a situation, courts should consider the "type and scope of authority" given to the party assigned to resolve the dispute. However, the court held that the language in the merger agreement was not such a difficult case, and clearly provided for an expert determination.

Having determined the agreement called for an expert determination, the court concluded that the merger agreement then determines the scope of the expert's review. Whether the Accounting Firm has jurisdiction to determine the scope of the dispute resolution provisions and consider extrinsic evidence is a matter of contract interpretation. Absent explicit direction from the terms of the contract itself, the expert charged with making the decision does not have authority to interpret the governing agreement. Finding no express provision in the merger agreement bestowing jurisdiction on the Accounting Firm to interpret the merger agreement, the court held that the Accounting Firm was not permitted to do so or to determine whether it had jurisdiction to consider extrinsic evidence.

The court then turned to the plain language of the dispute resolution mechanism in the merger agreement to answer the question whether the Accounting Firm could consider extrinsic evidence in answering the question posed by the parties regarding the allocation of tax benefits. Regardless of whether the allocation dispute is viewed as arising under the pre- or post-closing tax benefit provisions, the dispute mechanism of Section 2.8(b) applied. The pre-closing tax benefit provisions specified that dispute resolution provisions "corresponding to those in Section 2.8(b)" applied. The post-closing tax benefit provisions specified that the determination of disputed items should be made by the Accounting Firm "following the general procedures set forth in Section 2.8(b)(ii), *mutatis mutandis*." Interpreting this Latin phrase as "the necessary changes have been made," the Seller argued that in applying the procedures of Section 2.8 to a tax dispute, a necessary change must be made in order to allow the Accounting Firm to use extrinsic evidence to resolve a tax question, such as sources of positive law and guidance from tax authorities. Once this extrinsic evidence is permitted, the Seller argued that the term sheets and the offering circular should be allowed as well. The court disagreed, finding that "*mutatis mutandis*" simply meant the Accounting Firm was considering a tax question instead of an accounting question. Just as accounting guidance would have been available to it in the latter case, tax guidance was available to it in this case. The court held that the plain language of the merger agreement clearly provided that no additional information was to be considered other than the materials expressly permitted by Section 2.8.

Takeaways

Without the explicit language that the Accounting Firm was to act as an expert and not an arbitrator, coupled with the narrow process for its review as outlined in the merger agreement, the dispute resolution provisions may have allowed the introduction of materials beyond what the parties initially intended. When drafting a dispute mechanism, parties should be explicit in the scope of authority granted to the third-party decision maker, as well as the materials available to them for their review.

The decision also provides a cautionary note on incorporating dispute resolution mechanisms by reference to other provisions in the agreement. The dispute resolution provisions in *Penton* were doubtless prepared with a purchase price adjustment in mind. There, it is reasonably common to provide that the person charged with resolving disputes should function as an expert and not an arbitrator. It is not uncommon for drafters, out of a concern for efficiency, to piggyback other disputes into the purchase price adjustment dispute resolution provisions. Where that is done, attention should be given as to whether an expert determination is appropriate for these other types of disputes. If not, modifying language should be incorporated into the purchase agreement.

Another takeaway for sellers is that the tax benefit provisions should be carefully thought through. In *Penton*, there was a significant economic difference on whether tax benefits were applied to the pre-closing period or the post-closing period. In the absence of express language to the contrary, the buyer will typically be the party to decide how to use the benefits, as was the case in *Penton*. If there may be a big economic difference depending on the period they are applied to, sellers should consider pushing for express language in the purchase agreement that specifies how benefits are to be applied.

Manti Holdings, LLC v. Authentix Acquisition Co., No. 2017-0887-SG, 2018 BL 353784 (Del. Ch. Sept. 28, 2018)

Delaware Chancery Court held for the first time that a contractual appraisal waiver in a drag-along was enforceable against holders of common stock.

Delaware courts have previously recognized that holders of preferred stock may contractually waive their appraisal rights *ex ante*, given that their rights are largely contractual in nature.[6] Until *Manti*, the issue of whether holders of common stock may also contractually waive appraisal rights *ex ante* was unresolved by Delaware courts. In a summary judgment proceeding, the *Manti* Court held that they can.

Manti involved an appraisal action brought by holders of common stock in connection with a cash merger in which they would receive little, if anything, for their shares. The merger was initiated by the controlling stockholder, the Carlyle Group, pursuant to the exercise of drag-along rights under a stockholders' agreement (the SA), to which the appraisal petitioners were parties. The court considered whether the petitioners were barred from exercising appraisal rights as a result of waiver language in the SA.

Section 3(e)(iv) of the SA obligated parties in connection with a "Company Sale," such as the merger, to "refrain from the exercise of appraisal rights with respect to the transaction. The court examined the language of the SA to determine whether it indicated the requisite clear intent to waive. It first considered whether the obligation to refrain from exercising appraisal rights terminated under SA Section 12, which provided that the SA, and the rights and obligations of the parties thereunder, terminate upon a Company Sale. The parties agreed that vested rights would not terminate under Section 12, but petitioners argued that the obligation to refrain from exercising appraisal rights did not vest. Rejecting petitioners' argument, the court noted that the rights and duties under Section 3(e)(iv) arose at the time "a Company Sale is approved by the Board." The court held that this language was unambiguous, and no contracting party would consider itself free to exercise appraisal rights where the Board had approved a Company Sale. The court noted that petitioners' argument would render Section 3(e)(iv) inutile because appraisal rights are meaningless unless a transaction is completed.

Petitioners also argued that the duty to refrain from appraisal and otherwise comply with the drag-along provisions of the SA was conditioned on petitioners' securities being acquired on the same Terms and Conditions as those of the Carlyle Group. Under the SA, "Terms and Conditions" was defined to mean price. Petitioners argued that that condition was not satisfied because holders of preferred stock and common stock received different consideration under the waterfall provisions of the target company's charter. The court rejected petitioners' argument on the basis that the same "Terms and Conditions" condition only applied to Company Sales involving the sale of stock and not, as was the case here, mergers.

The court also rejected petitioners' argument that even if the appraisal waiver was enforceable, it was not enforceable by the target company. The petitioners argued that permitting the company to enforce the appraisal waiver would amount to a violation of Section 151(a) of the Delaware General Corporation Law, which requires limitations on classes of stock to be included in the corporate charter. Rejecting this argument, the Court held that the SA did not restrict the appraisal rights of a class of stock, but instead represented a contractual agreement by petitioners to forbear exercising such rights.

Takeaways

This decision settles a question that existed for funds and other controlling investors in connection with structuring their investments. The decision makes clear that properly drafted and enforced appraisal waivers in drag-along provisions can

[6] *See, e.g. Halpin v. Riverstone Nat'l, Inc.*, C.A. No. 9796-VCG (Del. Ch. 2015).

be enforced against holders of common stock. It therefore reduces potential leverage that founders and other holders of common stock may have in connection with the exercise of drag-along provisions. While this resolves one area of uncertainty concerning drag-along rights, there remain others, as alluded to by the court in the following dicta: "notably, the Petitioners have not brought an action against the directors for breach of fiduciary duty or breach of contract." Drag-along provisions remain vulnerable to *Trados*-type fiduciary duty challenges,[7] and may also not be upheld where, as in *Halpin*, their terms are not strictly complied with.

Deutsche Bank National Trust Co. v. Flagstar Capital Markets et al., 2018 NY Slip Op. 06851 (N.Y. Oct. 16, 2018)

In contrast to Delaware, New York does not permit extension of the statute of limitations for breach of contract, and attempts at inception of a contract to delay commencement of the statute of limitations may violate public policy against pre-accrual extensions and be unenforceable.

Background

This decision concerns whether claims brought against the originator of mortgage loans, Quicken Loans Inc. (Quicken), that were used to create residential mortgage-backed securities (RMBS), were time barred under New York's statute of limitations applicable to breaches of contact, consistent with a prior RMBS decision of the New York Court of Appeals in *ACE Sec. Corp. Home Equity Loan Trust, Series 2006-SL2 v. DB Structured Prods., Inc.*, 25 NY3d 581 (2015), notwithstanding the existence of an "accrual clause" that purported to delay the date on which a cause of action arose.

In *Flagstar Capital*, Quicken sold the loans it originated pursuant to a Second Amended and Restated Mortgage Loan Purchase and Warranties Agreement (MLPWA). Under the MLPWA, the loans were sold in groups, with Quicken making representations and warranties about the loans as of each applicable closing date. The last closing occurred on May 31, 2007. The loans were ultimately re-sold to the HarborView Mortgage Loan Trust 2007-7 (Trust) for the purpose of issuing mortgage-backed securities. Plaintiff Deutsche Bank National Trust Co. (Deutsche Bank), the trustee of the Trust, succeeded to the rights of the purchaser under the MLPWA.

After an underwriter engaged to review a sample of the loans concluded that Quicken had breached its representations and warranties with respect to certain loans, including with respect to borrower income, debt-to-income ratios and occupancy status, Deutsche Bank commenced its action in August 2013 and filed its complaint in February 2014. Quicken then moved to dismiss the complaint on grounds that it was filed more than six years after the last closing date in violation of the statute of limitations applicable to contracts in New York.

In opposition to Quicken's motion, Deutsche Bank did not contest that the representations and warranties in the MLPWA were effective as of the applicable closing date; rather, it contended that the statute of limitations had not lapsed because of the application of the following provision, which it called the "accrual clause":

> "Any cause of action against the Seller relating to or arising out of the breach of any representations and warranties made in Subsections 9.01 and 9.02 shall accrue as to any Mortgage Loan upon (i) discovery of such breach by the Purchaser or notice thereof by the Seller to the Purchaser, (ii) failure by the Seller to cure such breach, substitute a Qualified Substitute Mortgage Loan or repurchase such Mortgage Loan as specified above and (iii) demand upon the Seller by the Purchaser for compliance with this Agreement."

[7] *See In re Trados Inc.* S'holder Litig., 73 A.3d 17 (Del. Ch. 2013).

The lower court granted Quicken's motion to dismiss, holding that the action was time-barred because (1) any breach of Quicken's representations and warranties occurred, and Deutsche Bank's claims therefore accrued, on the relevant closing date (the last of which occurred more than six years before the action was filed), and (2) the accrual clause could not serve to extend the statute of limitations. The Appellate Division affirmed, and granted Deutsche Bank leave to appeal to the New York Court of Appeals.

Analysis of New York Court of Appeals

The New York Court of Appeals affirmed. The court first noted that the default rule in New York for breach of contract causes of action is that the cause of action accrues when the contract is breached. The court explained: "[t]his Court has 'repeatedly rejected accrual dates which cannot be ascertained with any degree of certainty, in favor of a bright line approach,' and for that reason, we do not 'apply the discovery rule to the statute of limitations in contract actions.' 'To extend the highly exceptional discovery notion to general breach of contract actions would effectively eviscerate the Statute of Limitations in this commercial dispute arena.'"

The court noted that the default rule had been applied in its earlier decision in *ACE*, and if that decision was controlling here, Deutsche Bank's claims would be time barred. *ACE* also involved breach of representations and warranties in an RMBS contract, where the loan seller similarly had a "cure or repurchase" obligation. The court noted that in *ACE*, it held that the "cure or repurchase" obligation did not create a "separate promise of future performance" that could form the basis of a separate breach (with the statute of limitations starting to run from that time of that breach as opposed to the breach of the underlying representation and warranty). Instead, the "cure or repurchase" obligation merely set forth a remedy for a breach of the representations and warranties, and not a promise of the loans' future performance. The court also noted that in *ACE*, it rejected the plaintiff's argument that the cure or repurchase obligation was a substantive condition precedent to the filing of an action which delayed the accrual of the plaintiff's cause of action, holding that "'the plaintiff breached the representations and warranties in the parties' agreement, if at all, the moment the [relevant contract] was executed' and therefore '[t]he Trust suffered a legal wrong at [that] moment.'"

The court then considered Deutsche Bank's arguments that *ACE* did not control because the contract at issue in *ACE* did not contain an accrual clause, and thus *ACE* was distinguishable in two respects: (1) the accrual cause created a substantive condition precedent to suit and (2) the accrual clause evidenced the parties' intent to delay accrual of a cause of action until specified events had occurred. The Court rejected both arguments.

In support of its first point —that the accrual clause created a substantive condition precedent to suit—Deutsche Bank argued that the phrase "shall accrue" in the accrual clause evidenced the parties' intent to define a breach of the MLPWA not as the falsity of the representations and warranties alone, but as Quicken's failure to cure or repurchase nonconforming loans following notice or discovery of the falsity and after Deutsche Bank's demand for compliance with the MLPWA's terms. The court disagreed, noting that "[t]he accrual clause itself refers to a 'breach' of the representations and warranties, and the contract nowhere suggests that [Quicken's] transfer of loans that do not comply with the representations and warranties is not a 'breach of the MLPWA. Rather, the MLPWA states that [Quicken's] obligations to cure or repurchase a defective mortgage loan constitute [Deutsche Bank's] 'sole remed[y] for a 'breach of the foregoing representations and warranties.'" As in *ACE*, the "cure or repurchase" obligation set forth a remedy for a breach of representations and warranties and not a demand that is a condition to a party's performance. The performance obligation here was for Quicken to deliver loans that complied with the representations and warranties. Nothing in the accrual clause created a condition to Quicken's obligation to do that.

In support of its second point, Deutsche Bank argued that the "accrual clause manifests the clear intent of the parties that a cause of action for breach of the representations and warranties 'comes into existence (accrues)—only after the conditions of the [a]ccrual [c]lause are complete,' meaning that the statute of limitations is not triggered until that time." The court again rejected Deutsche Bank's argument, explaining that if Deutsche Bank's characterization of the parties' intent were true, it conflicts with New York law and public policy. Citing to precedent, the court explained that parties cannot extend the applicable statute of limitations before the relevant cause of action accrues. Further, even if parties do agree to extend the applicable limitations period following accrual, the court noted, they cannot extend it beyond the applicable limitations period: "[New York General Obligations Law Section 17-103] requires an agreement to extend the statute of limitation to be made 'after accrual of the cause of action,' and it allows extension of the limitations period only for, at most, the time period that would apply if the cause of action had accrued on the date of the agreement, i.e., six years from the date the agreement was made if the limitations period is six years." Accordingly, the court held that the accrual clause violated General Obligations Law Section 17-103 because (1) it was effectively an agreement to extend the statute of limitations before the accrual of the relevant cause of action and (2) it was an agreement to extend the limitations period for up to the life of the loans (i.e., in excess of the permissible six years), until discovery or notice of breach.

The court noted that the public policy favoring freedom of contract was in conflict with the public policy prohibiting extensions of the limitations periods before accrual of the cause of action, and the latter must prevail. Remedy for that lies with the legislature, which could enact a provision similar to that enacted under Delaware law, Del. Code Ann. Tit 10, § 8106(c).

Takeaways

While the decision involved an RMBS securitization, it nonetheless has relevance for M&A practitioners. As an initial point, given that statutes of limitations involve procedural, and not substantive, law, acquirors may prefer specifying Delaware over New York as a forum for dispute resolution, given the ability to extend statutes of limitations under Delaware law. Parties that are dealing with the New York statute of limitations should not rely on contractual language attempting to delay accrual of breach of representation and warranty causes of action, because the delay language is likely to be unenforceable. The dissent in *Flagstar Capital* noted that the outcome could have been different if the agreement had instead been structured as a guaranty by Quicken of the performance of any defectively issued loans. Accordingly, where survival of longer than six years is desired for claims under acquisition agreements that are subject to New York's statute of limitations, consideration should be given to whether the claims can be fashioned as guarantees instead of relying on remedies for breach of representations and warranties.

Basho Techs. Holdco B, LLC v. Georgetown Basho Investors, LLC, 2018 WL 3326693 (Del. Ch. July 06, 2018)

Stockholder use of blocking rights as part of aggressive strategy to gain majority voting control and force sale of company risks liability under entire fairness standard of review.

Background

Basho Technologies, Inc. (Basho or the Company) was a technology company co-founded by Earl Galleher in 2008. In February 2011, Basho completed a Series D round financing that was led by defendant Georgetown Basho Investors, LLC (Georgetown). Defendant Chester Davenport, who controlled Georgetown, joined the Basho board in connection with the financing. In subsequent financing rounds, Georgetown obtained an additional board seat (to give it two out of seven seats) and a blocking right over events such as M&A transactions and the issuance of shares having rights that were superior to or *pari passu* with its preferred stock rights. Evidence produced at trial indicated that Davenport wanted to force a sale of

Basho in 2013, that he anticipated that Georgetown would receive the largest share of the proceeds in any such sale, and that Davenport viewed the blocking rights as having turned Georgetown into the company's sole life line for funding.

Over the next several months, Davenport went to great lengths to prevent the company from obtaining financing from a third party that would dilute Georgetown's position. That forced the board to negotiate a bridge loan with Georgetown under less favorable terms. And as a condition to the bridge loan, Georgetown required that the company retain Cowen & Company as a financial advisor for both fundraising and a potential sale.

After an unsuccessful effort to sell the company in the first quarter of 2013, Davenport instructed Cowen to implement a Series G financing round through which Davenport used aggressive tactics like delays, threats, and imposition of unreasonable deadlines to scuttle a potential transaction with another investor and to force the company to accept Georgetown's less favorable financing proposal. The financing gave Georgetown control over a majority of Basho's outstanding voting power and the right to appoint a majority of the members of the board.

Promptly after closing, Davenport consolidated his power by removing Galleher as Chairman of the Board and giving the role to himself, creating an Executive Committee with the full power of the board in the management of the company, composed of Davenport, Reisley (a Georgetown colleague), and the future CEO, and giving Davenport and Reisley control over the remaining board committees.

Davenport then caused the company to enter into a number of insider transactions, such as by entering into a more lucrative consulting agreement with a company controlled by Reisley, and entering into new loan arrangements with Georgetown and another entity controlled by Davenport. After some signs of good financial performance, Basho's performance declined and Basho ceased operations as a going concern in May 2017.

Fiduciary Duty Claims

Galleher and other former holders of the company's common stock and preferred stock filed suit in 2015 alleging, among other things, breach of fiduciary duties by Georgetown and Davenport by forcing the company to accept the onerous Series G financing.

The court considered whether Georgetown owed fiduciary duties in connection with the Series G financing. Because Georgetown did not exercise a majority of the company's voting power before the Series G financing, the plaintiff attempted to prove that Georgetown exercised control over the transaction being challenged. The court held that this required a showing of actual control, not merely the potential ability to exercise control.

The ourt noted that a finding of control generally involves the analysis of multiple factors and held that the plaintiffs proved at trial that Georgetown exercised effective control due to:

- Georgetown's use of its contractual rights, including its blocking rights and its delaying of draws under the loan agreement, to give the company no alternative other than to accept Georgetown's terms.
- Davenport's efforts to spread misinformation about Georgetown's intentions and the status of negotiations.
- Davenport's interference with members of management.
- Davenport's influence over Cowen, and his resulting manipulation of the fundraising process.
- Georgetown having forced the Series G financing on the company, including through Davenport's threats and combative behavior.
- Georgetown's status as a significant stockholder and its ability to designate two board seats.

Having established that both Georgetown and Davenport were fiduciaries in connection with the Series G financing, the court considered whether they had breached their fiduciary duties. The court applied the entire fairness standard of review to this transaction, which requires a finding of fair price and fair dealing.

The court had little difficulty in finding that the process was unfair. It noted that Georgetown interfered with competing investments to prevent them from moving forward. Georgetown dictated, and refused to negotiate, the terms of its own proposal. The court found that the Board and stockholders only approved the deal because the directors felt they had no alternative.

The court noted that the defendants did not present any meaningful evidence of financial or economic fairness. The defendants instead argued that the Series G financing must have been fair because no other party submitted an actionable proposal. The court interpreted the absence of other actionable proposals as more indicative of the unfair process than fairness of the price. The Court noted that there was a lot of evidence that the price was unfair.

The court found that Davenport and Georgetown failed to prove that the Series G financing was entirely fair. The court also found that plaintiffs proved that the financing injured the company and the plaintiffs. The court rejected defendant's argument that Galleher and companies he controlled were not entitled to relief because they acquiesced to the terms of the transaction. The court held that the doctrine of acquiescence does not apply in situations like this, where the fiduciaries "use their power to coerce the minority into economic submission." Having found a breach of fiduciary duty, the court held Georgetown and Davenport jointly and severally liable for losses in the amount of $17,490,650, plus pre- and post-judgment interest. The court then considered liability of Georgetown, Davenport and Fotos for breach of fiduciary duty for self-dealing transactions after the Series G financing, and found them jointly and severally liable for damages of $2,778,228, plus pre- and post-judgment interest.

Takeaways

This case is a warning to investors seeking to use negative control rights as part of a hostile strategy to force a company down a path that benefits the investor but is not in the best interest of the corporation or other investors. It is particularly relevant to venture-backed companies, where charters routinely include protective provisions that give the most senior securityholders blocking rights over financings and other strategic transactions. The court went out of its way to make clear that use of such provisions does not, in and of itself, create control that triggers an entire fairness standard of review. The court wrote in a footnote:

> Lest sensitive readers fear that this decision signals heightened risk for venture capital firms who exercise their consent rights over equity financings, I reiterate that a finding of control requires a fact-specific analysis of multiple factors. If Georgetown only had exercised its consent right, that fact alone would not have supported a finding of control. The plaintiffs proved that Georgetown and Davenport did far more.

The court's decision was driven by the use of consent rights in the context of a strategy built around deception, manipulation, and threats to obtain absolute control and force a sale, coupled with significant stock ownership and right to two out of seven board seats. But control is not a bright line test. Investors with veto rights should take note of the decision when formulating exit strategies for their portfolio companies.

Arnold & Porter

In re PLX Tech. Inc. S'holders. Litig, 2018 WL 5018535 (Del. Ch. Oct. 16, 2018)

Decision provides useful insights for companies and boards in dealing with activists who obtain board representation and drive agenda to sell company, and helpful reminder of general principles for running a good sale process.

In *In re PLX Technology Inc. Stockholders Litigation*, the Delaware Court of Chancery ruled that an activist hedge fund, Potomac Capital Partners II, L.P. (Potomac), acting through its co-managing member, Eric Singer (Singer), who had gained a seat on the Board of Directors (the board) of PLX Technology Inc. (PLX or the Company), aided and abetted a breach of fiduciary duties by the board in connection with the sale of PLX to Avago Technologies Wireless (U.S.A.) Manufacturing Inc. (Avago) pursuant to a two-step merger (the Merger). The court found that the board members breached their fiduciary duties as a result of various process and disclosure deficiencies to stockholders, many of which were due to Singer having manipulated the sale process and Singer and the company's financial advisor having withheld information from the other board members. Although Potomac, as a result of aiding and abetting the breach, would be liable for the difference between the transaction price and the fair value of PLX, the Court of Chancery held that plaintiffs failed to prove that the standalone value of PLX was greater than the deal price, and accordingly entered judgment in favor of Potomac.

Background

One of the ironies of the case is that Singer launched his activist campaign to force a sale of PLX as a result of information set forth in PLX's proxy statement relating to a prior sale transaction, which was terminated after being challenged by the Federal Trade Commission. Singer learned from the proxy statement that another company (Avago) had expressed interest in buying PLX during the "go shop" period for the terminated deal. When PLX's stock price tanked after the prior deal was terminated, Singer saw an opportunity to cause Potomac to accumulate a position in PLX, and generate a quick profit by forcing a sale of PLX to that other company. Singer went public with its campaign, and Potomac built up a stake in the Company of almost 10%. After Singer went public, the board engaged in another process to explore a sale, including holding further discussions with Avago, although that process was unsuccessful and discussions with Avago broke down over price. The board was concerned with Singer's singular focus on an immediate sale, and believed the timing was not right. Mike Salameh, the company's founder and a board member, communicated to Singer the board's need to fulfill its fiduciary obligations and "consider the interest of the holders of PLX stock that you do not represent, particularly the holders that may have a longer time horizon than Potomac Capital."

Potomac commenced a proxy contest to gain board representation in connection with the company's 2013 annual meeting. Potomac won three out of eight seats in the proxy contest, and its nominees joined the board in December 2013. Upon the election of the Potomac directors, the board appointed Singer as the chairman of a special committee of the board (the Special Committee), which was tasked with exploring strategic alternatives for the company. From that point on, Singer assumed the lead role in driving strategy and negotiating on behalf of the company in connection with a potential sale or other strategic alternatives.

After Singer was appointed as the chairman of the Special Committee, an executive for Avago contacted a banker at the company's financial advisor and informed him that Avago was interested in acquiring PLX in "a $300M deal," which implied a PLX per share value of $6.53, but that Avago would not be able to execute the transaction until it completed another pending transaction. The financial advisor provided this information directly to Singer, but not to any other members of the board. The record at trial showed that Singer did not provide this information to other board members and this communication was not disclosed in the recommendation statement on Schedule 14D-9 (the Recommendation Statement) provided to PLX stockholders in connection with Avago's subsequent tender offer, which was the first step of the Merger.

Once Avago had completed its other transaction, discussions between PLX and Avago advanced rapidly. Avago initially proposed to acquire PLX for $6.25 per share. Nine days later, Avago and PLX had agreed in principle to a deal at $6.50 per share, which was very close to what Avago had previously communicated to the company's financial advisor that it was willing to pay. Singer, as chairman of the Special Committee, led the negotiations with Avago and was instrumental in convincing the other board members to approve the transaction. The transaction was publicly announced on June 23, 2014. The first step tender offer was commenced on July 8, 2014.

On July 14, 2014, plaintiffs filed suit against various parties, including all of the members of the board for breach of fiduciary duties and against Potomac for aiding and abetting the breach. The plaintiffs settled with all of the directors, including Singer, so the case only proceeded against Potomac for the aiding and abetting claim.

Breach of Fiduciary Duty

Disclosure

Vice Chancellor Laster found that the board breached its fiduciary duty to disclose fully and fairly all material information within the board's control in seeking shareholder action (i.e., the tender of shares into the first-step tender offer in the Merger). In particular, he identified three deficiencies in the disclosures made in the Recommendation Statement that would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

First, the Recommendation Statement failed to disclose, and indeed was found to have downplayed, the extent to which Singer was involved in the negotiation of the deal price. Singer had a number of important conversations with Avago and the company's financial advisor and appears to have been the primary interlocutor responsible for negotiating the $6.50 per share deal price, which was virtually identical to the valuation that Avago had initially indicated to the company's financial advisor that it was willing to pay for PLX a number of months prior to the agreement being reached. In light of Singer's deep involvement and the potential conflict of interest Singer had as the principal of an investor with a short-term and activist investment thesis, Vice Chancellor Laster found that the Recommendation Statement should have included additional information about Singer's role in the process. Most importantly, the Recommendation Statement should have disclosed that the company's financial advisor told Singer well in advance of formal negotiations that Avago expected a transaction that would be valued at around $6.50 per share.

Second, the Recommendation Statement misleadingly described the process by which projections used to support the valuation of PLX in the transaction were updated in June 2014 to arrive at a valuation that supported the $6.50 deal price. PLX had prepared projections reviewed by the board in December 2013 (the December 2013 Projections) that reflected significantly higher revenue growth and profitability than the projections that were ultimately used to support the valuation in the fairness opinion provided by the company's financial advisor. The Recommendation Statement characterized the December 2013 projections as having been an aggressive plan, and stated that that they were updated in June 2014 (the June 2014 Projections) to provide more current information and were prepared in the ordinary course of business for operating purposes. In fact, the June 2014 projections did not provide more current information and were not prepared until after the $6.50 per share deal price had been agreed with Avago. Vice Chancellor Laster found the June 2014 projections were prepared solely for purposes of providing a set of projections to the company's financial advisor that could support a valuation range that encompassed the merger price and enable the company's financial advisor to deliver a fairness opinion and, accordingly, that the disclosures regarding the purpose for which the June 2014 Projections were prepared were misleading.

Third, on May 24, 2014, the company's financial advisor made a presentation to the board that contained a valuation range of $6.90 to $9.78 per share for an acquisition of the company, with a midpoint of $8.27 per share. That valuation range was based on the December 2013 projections and was not disclosed to shareholders. It is notable that the entire range of that valuation exceeded the eventual agreed deal price with Avago. The Recommendation Statement did disclose two subsequent valuations, including one based on the December 2013 projections that showed a valuation range of $6.39 to $8.98 per share, with a mid-point of $7.69, but did not disclose the May 24, 2014 valuation range based on the December 2013 projections. Although Vice Chancellor Laster believed it was a close call whether all three valuation ranges should have been disclosed, he concluded stockholders were entitled to know the range produced in the May 24, 2014 valuation and that its omission was a misleading partial disclosure.

Sale Process

The Court of Chancery also found that the board breached its fiduciary duties in connection with the sale process. The Court of Chancery applied enhanced scrutiny as the operative standard of review, explaining that the business judgment standard under *Corwin v. KKR Financial Holdings, LLC*[8] did not apply because of the disclosure issues described above.

Vice Chancellor Laster found that Singer and Potomac had a divergent interest in achieving a short-term sale that was not aligned with the stockholders writ large. Potomac's activist approach to investing generally and the investment thesis supporting this particular investment—that the terminated prior deal created an opportunity to purchase the stock at a cheap price and force a quick sale—convinced Vice Chancellor Laster that Singer and Potomac's interests diverged from other stockholders, who might have been better served if PLX remained independent and executed on its business plan, notwithstanding the board's prior attempts to sell the company.

Vice Chancellor Laster's opinion focuses on the ways in which the board failed to provide an effective check to the divergent interests of Singer and Potomac, remarking that "this was a board that was susceptible to activist pressure." Notably, after Singer and the other Potomac nominees joined the board, the board (i) became much more willing to consider a transaction at prices the board had previously rejected, (ii) ceded significant control over the strategic alternatives process to Singer and allowed him to lead the negotiations with Avago, (iii) agreed to let Singer make a counter-offer to Avago and granted authority for a deal at $6.50 when the board did not yet have a stand-alone valuation of the Company, (iv) engaged in the "art of the possible" regarding the price at which the company could be sold (i.e., sought the best available price for the company) rather than considering the sale price as an alternative to remaining a standalone company, and (v) through the Special Committee, instructed management to prepare the May 2014 projections to support the deal price even though there had not been any new developments in the business since the preparation of the December 2013 projections and decided the company's financial advisor did not need to engage in any additional pre-signing market checks. Taken together, these factors led Vice Chancellor Laster to conclude Potomac and Singer undermined the board's process and resulted in a deal the board would not have otherwise approved.

The opinion does note that, absent the divergent interest of Singer, the process the board pursued, including the narrow, pre-signing canvass, a post-signing market check and a no-shop clause in the merger agreement with a fiduciary out, a customary termination fee and a matching right, would fall within the range of reasonableness. Noting the laundry list of deficiencies in the process discussed in the prior paragraph, Vice Chancellor Laster wrote that he still would have found that the board's decisions fell within the range of reasonableness but for the critical fact that Singer withheld from the board that Avago had told the company's financial advisor in December 2013 about its plans to acquire PLX. In

[8] 125 A.3d 304 (Del. 2015).

withholding this information from the board, Singer breached his fiduciary duty and induced the other directors to breach theirs. Because Singer was a co-managing member of Potomac and its agent, led Potomac's activist campaign and acted on its behalf once elected to the board, Singer's actions were attributable to Potomac and supported a finding that Potomac knowingly participated in the steps Singer took to breach his fiduciary duties and induce the other directors to breach their fiduciary duties.

Damages

The robustness and length of the sale process ultimately redounded to Potomac's benefit when it came to the damages determination. Vice Chancellor Laster held that in a quasi-appraisal remedy such as this, the plaintiff has the burden of proving damages based on the difference between the $6.50 price per share paid by Avago and the "fair" or "intrinsic" value of the shares. Vice Chancellor Laster found a number of problems with plaintiffs' valuation expert, and, giving significant weight to the Delaware Supreme Court's decision in *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017), ultimately held that the $6.50 deal price was the best measure of fair value. Accordingly, Vice Chancellor held that the plaintiffs had not suffered any damages, and entered judgement for Potomac.

Takeaways

The opinion provides several important lessons for boards in the context of shareholder activism. Prior to the annual meeting, the directors correctly focused on their duty to do what was in the best interests of the stockholder body as a whole, and not simply cave to the demands of an activist with a short time horizon. After the activist's three nominees were elected to the board, the board's principal mistake seems to have been to treat a sale as inevitable, and cede too much control over the strategic alternatives process to Singer. Singer and Potomac were not only conflicted, but they actively manipulated the sale process by withholding important information from other board members. Vice Chancellor Laster noted that the directors (other than Singer) were not at fault for Singer's withholding of information in a "morally culpable" sense, but it nonetheless resulted in a breach of their fiduciary duties. The lesson for future boards is that even in the case of a lost proxy contest, boards of directors must continue to independently exercise their fiduciary duties to take the course of action that best serves the interests of company stockholders, and consider the implications of governance arrangements that may yield effective control to an activist.

As a related point, the decision provides legal ammunition to boards defending their actions in pursuit of the long term interests of stockholders over the short term interests of activists. Vice Chancellor Laster invoked *In re Answers Corp. S'holder Litig*.[9] for the proposition that a desire for liquidity can lead directors to breach their fiduciary duties. That case is a favorite for plaintiffs' firms challenging sale transactions that are driven by a private equity or venture fund with board representation, where the fund allegedly wants an exit transaction for reasons that are particular to that fund, such as to assist in future fundraising efforts. As Vice Chancellor Laster has made clear, the decision also applies in the context of activist shareholders whose strategy is to make a quick return by forcing an immediate sale of the company.

The decision is also a reminder that activist nominees who are elected to boards, whether they are nominally independent or are affiliated with the activist fund, are subject to the same duties of loyalty and care as other directors. They cannot simply use their board seats to pursue the activist's sale or other agenda if to do so would not be in the best interests of the stockholders of the company as a whole.

The decision also provides several important reminders that are relevant to M&A processes in general. The opinion reinforces the need to ensure disclosure to stockholders is full and fair and that stockholder action is fully informed. If proper disclosures had been made, particularly regarding Singer's conversation with the company's financial advisor at

[9] 2012 WL 1253072 (Del. Ch. Arp. 11, 2012).

which Avago's pricing expectations were conveyed, the applicable standard of review under *Corwin* would have been the business judgment rule, and the case would have been dismissed. Directors nominated by third parties also must be vigilant to share information related to the company they obtain with the other members of the board of directors and stockholders, as and when appropriate, particularly where a potential divergence of interests may exist between the director or the entity to which the director's actions may be attributed and the other stockholders. Singer and Potomac's potential liability in this case stemmed from Singer's failure to disclose to the other directors that he had received information from the company's financial advisor regarding interest by Avago and a likely price at which Avago would be willing to transact, and the company's subsequent failure to disclose those communications to stockholders. A director nominated by an activist investor must still provide full disclosure to the Board of Directors and/or special committee when acting on behalf of the Board of Directors and should ensure that full and fair disclosure is made to stockholders at appropriate times.

Companies preparing projections should also continue to be conscientious of the multiple uses for which the projections may become relevant. While the December 2013 Projections appear to have been generated for ordinary business purposes, including compensation targets and insurance, and included some aspirational or aggressive elements, they became problematic when considered in tandem with the ongoing sale process and the fact that they resulted in a valuation range significantly in excess of that at which counterparties appeared willing to transact with PLX based on the various market checks. Being clear about the purposes for which projections are produced and considering their applicability in multiple contexts, including any potential transactional context, may help a company to make more complete disclosures regarding such projections when required.

The decision also has shades of *Del Monte*[10] and *Rural Metro*.[11] Those cases involved situations where the company's financial advisor ran amuck and pushed a sales process that favored its own interests over those of the corporation and its stockholders. *In re PLX* is a reminder of the need to police conflicts of investment banks and make sure that the board, and not the banker, is in control of the process.

In re PLX also provides a reminder of the importance of process. Although the directors were found to have breached their fiduciary duties, the robustness of PLX's sale process ultimately supported a finding that the plaintiffs had not suffered damages. Running good sale processes with strong market checks and appropriate deal protections remains essential to protecting companies and their directors.

[10] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011)

[11] *In re Rural Metro Corp.*, 88 A.3d 54 (Del. Ch. 2014), aff'd sub nom. *RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816 (Del. 2015)

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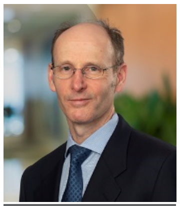

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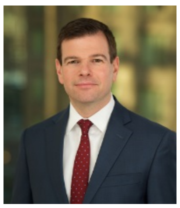

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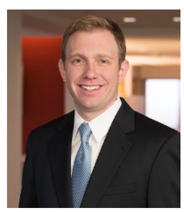

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