Internal Revenue Service

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Date:
May 07, 2010

LEGEND:

Date 1 =

Date 1.5 =

Date 1.9 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Recent Date =

Recent Date 2 =

Parent =

Stock Market =

Company 1 =

Company 2 =

Identified Holders =

Excess Cash =

Bank =

A =

B% =

C% =

D% =

$E =

F =

$G =

$GG =

GGG =

H =

J =

$K =

$L =

$M =

$N =

$O =

P =

Q =

Dear :

We respond to your letter dated December 14, 2009, and subsequent correspondence, in which you requested rulings as to certain federal income tax consequences of the transactions discussed below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information and other data may be required as part of the audit process.

FACTS

Parent is the common parent of an affiliated group of corporations that file a consolidated Federal income tax return on a 52/53 week fiscal year which ends on the Saturday nearest to January 31st (the "Parent Group," also referred to as the "Taxpayer"). The Parent Group is a loss group within the meaning of §1.1502-91(c)(1).

Parent was formed Date 1 and has a single class common stock outstanding (the "Common"). The Common trades publicly on the Stock Market. As of Recent Date, Parent had approximately A shares of Common outstanding, which were owned approximately B% by public shareholders, C% by Company 1, and D% by five Identified

Holders. Parent has never declared or paid any dividends or made any distributions with respect to its Common.

On Date 2, Parent issued all F shares of its Series A Redeemable Convertible Preferred Stock ("Preferred A") to Company 2 for $E. The Preferred A was convertible into an equal number of shares of Common, subject to anti-dilution adjustments, and was subject to mandatory redemption on the tenth anniversary of its issuance or upon a "change of control" at $G per share (i.e., for $E in the aggregate). On Date 2, Common was trading for about $GG per share and GGG shares of Common were outstanding. The Preferred A participated in dividends on the same basis as the Common and had a liquidation preference over the Common.

On Date 3 (shortly before the date on which the Preferred A was to be mandatorily redeemed for $E under its original terms), all of the Preferred A was redeemed (the "Preferred Stock Exchange") in exchange for—(i) H shares of Series B Redeemable Preferred Stock (the "Preferred B"), (ii) warrants to purchase up to J shares of Common Stock at $K per share ("Warrants"), and a cash payment of $L. On Date 3, Common was trading for only about $M per share and the Warrants were valued at $N.

The Preferred B is redeemable at any time by Parent for the initial redemption amount of approximately $O, plus accrued but unpaid dividends. The Preferred B accrues cumulative dividends at a base annual rate of P percent, subject to adjustment. All payments on the Preferred B will be applied first to any accrued but unpaid dividends, and then to the redemption of Preferred B. Q percent of the Preferred B (including accrued but unpaid dividends) is required to be redeemed on Date 4 and the remainder on Date 5. In addition, the Preferred B includes a cash sweep mechanism that may require accelerated redemption if Parent generates Excess Cash above agreed upon thresholds. The Preferred B (including accrued but unpaid dividends) is also required to be redeemed, at the option of the holders, upon a change in control. The Preferred B is not convertible into Common or any other security, but initially is entitled to vote with the Common on a one-for-one basis on general corporate matters other than the election of directors. In addition, the holders of the Preferred B Stock have certain class voting rights concerning the election of directors.

Parent has, on occasion, issued warrants to acquire Common to Company 1 in exchange for licensing, distribution and marketing agreements. Parent also has outstanding various non-statutory stock options and incentive stock options issued to employees, none of which were issued at a per share exercise price less than the fair market value of the Common on the date of grant.

As of Recent Date, Parent had no long term debt obligations outstanding. Parent has, however, recently entered into an agreement with Bank to establish a senior secured revolving credit facility. There were no borrowings against this credit facility as of the date of Taxpayer's initial letter.

REPRESENTATIONS

Taxpayer makes the following representations:

1. Parent Group has been a loss group within the meaning of §1.1502-91(c) of the Income Tax Regulations since its taxable year ended Date 1.9.

2. There have been no classes of Parent stock outstanding that constituted "stock" within the meaning of section 382(k)(6) and §1.382-2(a)(3) at any time during the period beginning Date 1.5 and ending Recent Date 2, other than the Common, Preferred A, and Preferred B.

3. Parent has treated and will continue to treat the Common, the Preferred A, and the Preferred B as equity for U.S. Federal income tax purposes.

4. None of the Common, the Preferred A, or the Preferred B satisfies the requirements of section 1504(a)(4). Accordingly, each of the Common, the Preferred A, and the Preferred B constitutes stock for purposes of section 382.

5. Other than the Preferred A issued on Date 2 and Preferred B issued on Date 3, Parent has not issued any additional shares of the Preferred A or the Preferred B, nor any rights to acquire the Preferred A or the Preferred B. Other than in the Preferred Stock Exchange, which occurred on Date 3, Parent did not redeem any of the Preferred A.

6. Parent has never declared or paid any dividends or made any distributions with respect to its Common.

7. Parent has treated, and will continue to treat, any Parent debt as debt for U.S. Federal income tax purposes.

8. Parent has not issued, nor has any Parent Group member issued, any contingent purchase, warrant, convertible debt, put, stock subject to a risk of forfeiture, contract to acquire stock, or option with a principal purpose of avoiding or ameliorating the impact of an ownership change.

9. To the best of the Taxpayer's knowledge, the amount of tax liability on any of Taxpayer's Federal income tax returns filed to date would not be affected by whether or not Taxpayer takes into account the effect of fluctuations in the relative values of different classes of stock for purposes of determining owner shifts and ownership changes under section 382.

RULINGS

For purposes of the rulings below, the Hold Constant Principle is defined as follows:

> On any testing date, in determining the ownership percentage of any 5-percent shareholder, the value of each share of such shareholder's stock, relative to the value of all other shares of the Taxpayer's stock, shall be considered to remain constant since the acquisition date of that share, except as properly adjusted to account for the dilutive effect of subsequent issuances or the accretive effect of subsequent redemptions of other shares of the Taxpayer's stock. The issuance of a second class of stock generally establishes the acquisition date for the preexisting class as well as the second class. For stock acquired before the beginning of any given testing period, the Taxpayer may use as its acquisition date the date that begins the testing period in lieu of its actual acquisition date(s), provided it does so with respect to every testing period and with respect to each and every share of stock so acquired.

Based solely on the information submitted, we rule as follows:

1. Taxpayer may apply a method employing the Hold Constant Principle (the "Method") to determine the increase in percentage ownership of each of its 5-percent shareholders on each of its testing dates on or after Date 2 (and to identify which such testing dates are change dates) for purposes of section 382, provided that—(i) Taxpayer takes a return position consistent therewith on its tax return for its first taxable year in which the application of the Method would affect the amount of its tax liability, and (ii) if employment of the Method does not result in an ownership change during said first taxable year, Taxpayer continues to apply the Method thereafter through the testing date on which the Method first results in an ownership change. See section 382(l)(3)(C).

2. In applying the Method, to the extent that there was a value-for-value recapitalization of Preferred A into Preferred B, such recapitalization shall be disregarded, and the exchanging shareholder shall be considered to have acquired such newly issued stock as of the date it acquired the stock exchanged therefor.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to whether or not—(i) any warrants or options should have been treated as exercised under §1.382-4(d), and (ii) any exchange of stock pursuant to a recapitalization represented a value for value exchange. Further, no opinion is expressed on the value of the Preferred B or the Warrants on the date of their issuance or what portion of the total value of the consideration paid in redemption of the Preferred A that the Preferred B or the Warrants

represented. One or more rulings given in this letter deal with issues that may be addressed in subsequent published guidance. See section 11 of Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 49-52, regarding the circumstances, including published guidance, which may result in the revocation or modification of a ruling letter.

PROCEDURAL STATEMENTS

This ruling letter is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, any taxpayer filing its return electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of this ruling letter.

In accordance with the power of attorney on file in this office, a copy of this ruling letter will be sent to your authorized representative.

Sincerely,

Mark S. Jennings
Branch Chief, Branch 1
Office of Associate Chief Counsel (Corporate)

cc: