EFiled: Dec 6 2007 11:31AM EST
Transaction ID 17551809
Case No. 3360-CC

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

UNITED RENTALS, INC., Plaintiff,	)	
v.	)	C.A. No. 3360-CC
RAM HOLDINGS, INC., and RAM ACQUISITION CORP., Defendants.	)	

EXPERT REPORT OF PROFESSOR JOHN C. COATES IV

Gregory P. Williams (#2168)
Raymond J. DiCamillo (#3188)
Richard P. Rollo (#3994)
John D. Hendershot (#4178)
Richards, Layton & Finger, P.A.
One Rodney Square
Wilmington, DE 19899
(302) 651-7700

Attorneys for Defendants RAM Holdings, Inc. and RAM Acquisition Corp.

OF COUNSEL:

Michael L. Hirschfeld
Scott A. Edelman
Daniel M. Perry
Milbank, Tweed, Hadley & McCloy LLP
One Chase Manhattan Plaza
New York, NY 10005

Dated: December 6, 2007

I. Summary of Report

1. I have been asked by RAM Holdings, Inc. and RAM Acquisition Corp. (the ***RAM Entities***) to provide expert testimony on customs and practice with respect to deal structures for buyouts of public companies by financial sponsors such as the deal at dispute in this case (the ***URI Deal***), as well as some customary practices for lawyers negotiating agreements for mergers and acquisitions (***M&A***).
2. I am a professor of law and economics specializing in M&A, including buyouts. My curriculum vita is annexed hereto as Exhibit A.
3. Based on my research, experience and an analysis of transactions comparable to the URI Deal it is my opinion that:
   a. Nothing about the URI Deal – assuming the interpretation of the relevant agreements urged by the RAM Entities – is unique or unusual, or would have been irrational or absurd for URI to accept. Rather, the URI Deal was consistent with industry customs and practices:
      i. Shell entities with few if any assets are often the buyers in buyouts of public companies by financial sponsors;
      ii. Buyout targets have long relied on the reputation of buyout sponsors to protect against the risks of non-consummation as much if not more than on contractual rights against buyer shells or sponsors;
      iii. Targets have in recent years developed the custom of seeking, but only sometimes obtaining, protection against the risk of non-consummation with limited guarantees of shell entity obligations from sponsors and/or third-party beneficiary rights under equity commitment letters;
      iv. Buyout deal structures commonly permit the buyout sponsor to refuse to complete a transaction in return for a fixed fee;
      v. Recent buyouts, including many negotiated by counsel to URI, were structured similarly to the URI Deal, with reverse termination fees similar in magnitude.

b. Attorneys negotiating buyout and other M&A agreements commonly economize on time and costs by using terms such as "subject to" or "notwithstanding" rather than attempting to synthesize provisions that otherwise would be partly or wholly potentially in conflict with one another.

4. The remainder of my report sets forth my qualifications (Part II) and the bases for my opinions. In Part III, I describe customary deal structures for buyouts of public companies by private buyout funds and changes in those deal customs over time, and my analysis and conclusions with regard to the URI Deal. In Part IV, I discuss customary practices for lawyers negotiating agreements for M&A such as buyouts.

II. Background / Experience

5. I am the John F. Cogan Jr. Professor of Law and Economics at the Harvard Law School. At Harvard among other courses I teach the basic course on Contracts and advanced courses on M&A, including basic principles of accounting, economics and finance as they relate to the design and implementation of business transactions.[1]

6. A copy of my *curriculum vitae* (including a list of all of my publications in the last ten years) is attached as Exhibit A. A list of cases in which I have testified as an expert at trial or by deposition in the last four years is attached as Exhibit B.

7. Before joining the Harvard faculty, I was a partner at the New York law firm of Wachtell, Lipton, Rosen & Katz. I worked at Wachtell Lipton from 1988 to 1997. In

[1] Before joining the Harvard faculty, I also taught M&A at New York University for five years, and I also served as an adjunct professor at Boston University, where I taught courses on M&A and the regulation of financial institutions such as banks, insurance companies, and mutual funds.

my practice at Wachtell Lipton, I represented large public companies and other firms involved in M&A and financial transactions.

8. Since joining Harvard Law School, I have provided or am providing consulting services to the Securities and Exchange Commission (***SEC***), the Department of Justice, the New York Stock Exchange, and other organizations and individuals actively involved in M&A and other corporate and financial transactions, including private equity funds, mutual funds, public and private companies, law firms, and investment banks, regulatory agencies, trade organizations, and entrepreneurs.[2]

9. As a consultant and while at Wachtell Lipton, I was or am a principal advisor in more than 50 completed transactions, including transactions involving Bank of America, GE, IBM, Sara Lee, USAir, and Valero Energy.

10. For 20 years, I have studied, researched, and taught and written about M&A, including buyouts, by (among other things) analyzing deal structures, their causes and consequences, and trends in deal structures over time. I have studied and written extensively about the law and economics of corporations and other business entities, and of corporate transactions, such as M&A transactions, as well as the contracts and customs and practices of business persons and lawyers relevant to such topics. I am the author *inter alia* of chapters in M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZEOUTS (a leading treatise on M&A), and for seven years, I co-authored a leading treatise on M&A in the financial industry, FINANCIAL INSTITUTIONS MERGERS AND ACQUISITIONS. My articles have appeared in *Stanford Law Review, California Law Review, University of Pennsylvania Law Review, Texas Law Review, Journal of*

[2] I have not previously provided services to the named parties to this case, whether as an attorney, consultant, or expert witness. I have previously worked as an expert for and against counsel to Cerberus.

Corporation Law, and *The Business Lawyer.* Articles of mine were chosen by legal academics as among the ten best corporate law articles in 1999, 2001, 2002, 2003 and 2004, and the best securities law articles in 2000.

11. I have testified at trial and by deposition in judicial proceedings as an expert witness on deal structures. For example, I have provided testimony on behalf of the Commonwealth of Massachusetts in a tax case in which a large corporation claimed that it had entered into corporate transactions as a takeover defense or for corporate finance purposes, and I have provided trial testimony in two unrelated cases (one in the Federal District Court of Connecticut, one in New Jersey state court) regarding M&A customs and practices relevant to those cases. The Delaware Supreme and Chancery Courts have cited several of my articles on M&A, including my article on termination fees.

12. I will receive my customary fee of $950 per hour for time spent on this litigation, including preparing this report and preparing and giving associated testimony. I understand I may be asked to give further testimony or opinions in this case.

III. Customs and Trends in Buyout Deal Structures

13. Buyout merger agreements are customarily signed not by the private equity funds or other entities that expect to own the ongoing equity in the post-buyout company – often called a "sponsor" of the buyout – but by shell entities (whether corporations, limited liability companies, or other limited liability entities) with few if any assets. This is and has been standard and customary for a long time. Targets and their

counsel understand this fact – indeed, here, URI specifically acknowledged this fact in Section 4(a) of the Limited Guarantee ("The Company acknowledges that the sole assets of Parent and Merger Sub are cash in a de minimis amount and its rights under the Merger Agreement, and that no additional funds are expected to be contributed to Parent or Merger Sub unless and until the Closing occurs.").

14. Because shareholders, directors, officers, employees and other agents of the shell entities will not under standard corporate law principles be liable for the obligations of the shell entities themselves, targets customarily understand that they will have few valuable rights under buyout merger agreements. Were the shells to default on their obligations, they would customarily have no assets to satisfy a default judgment. This is true notwithstanding the possibility of seeking specific performance of the agreements, since the shells would be unable to perform, even if directed to do so by a court.

15. Until recent years, moreover, even the obligations of these shell entities to close a buyout under a buyout merger agreement in the US were generally subject to "financing conditions," excusing the buyer shell entities from closing the buyout if financing were unavailable. The ability of the buyer shell entities to complete financing was often out of the control of the buyer shell entities, and even less in the control of the target. Inclusion of financing conditions meant that, as a practical matter, targets could not count on even the buyer shell entities to remain effectively bound to complete a buyout as a result of the buyout merger agreement. While the smaller buyouts that were typical in the 1990s and early 2000s rarely presented the risk that financing would be unavailable due to sheer illiquidity in the financing

markets, the obligations of the banks and other entities that were to provide capital were subject to a number of conditions (such as "due diligence outs") that provided ample opportunity for the financing to be declined as a result of new information developed while a buyout was pending, or as a result of changes in the target's business or results of operations.[3]

16. As a result of the foregoing customs and practices, it is and has long been the case that buyout targets rely on the desire of the buyout sponsor to preserve its reputation for being able and willing to complete transactions as significant protection against the risks of non-consummation. Targets have relied as much on reputation as on contractual rights. Counsel to URI, writing about buyouts generally, agrees, writing that "The persistence of this model [buyouts subject to a financing condition] would seem to indicate that many sellers remain satisfied that, absent financial market dislocations, the buyer will find a way to close the deal in order to avoid the reputational risk from not completing an agreed-upon transaction."[4]

17. In recent years, financing conditions have been less common in buyout merger agreements, due to a combination of increased competition among bidders, changing contracting norms (influenced in part by customs in Europe, where financing outs were always less common than in the US) and, perhaps, the concern by targets that as buyouts begin to grow rapidly in size (as they have in the last few years), the availability of financing began to become a greater risk for targets. Buyout funds

[3] See generally Eileen T. Nugent, Record Year Brings More Risk in Deal Terms: As Market Competition and the Size of Consortia Have Increased, Provisions of Acquisition Agreements Have Changed, International Financial Law Review, 2006 Guide to Mergers and Acquisitions (reviewing past custom of financing conditions and trend towards narrowing or elimination of those conditions, beginning in 2005).

[4] David J. Sorkin And Eric M. Swedenburg, Recent Developments In Financing-Related Provisions In Leveraged Buyouts, Simpson Thacher & Bartlett LLP Client Memo (Jan. 2006), at 5.

have grown enormously in size, making it feasible for them to provide significant financial commitments to buyout targets.

18. Even with the narrowing or elimination of financing outs, however, targets recognized that they could not effectively enforce the merger agreements against the buyer shell entities, for reasons discussed above. Targets thus negotiated for and sometimes obtained (subject to specified conditions) more certain remedies against buyout sponsors, including (a) guarantees by the buyout sponsors of some or all of the obligations of the buyout shell entities and (b) third-party beneficiary rights in commitment letters provided by those financing the buyout, and particularly from sponsor-related entities who were to provide equity for the buyout.

19. It has thus been the case that over the past few years, targets have customarily negotiated with buyout sponsors over whether they would guarantee shell entity obligations, the extent of such a guarantee, and/or whether targets will have third-party beneficiary rights under the sponsor's agreements with the shells. It is those provisions – which are customarily contained in agreements other than the merger agreement itself – that have been perceived as providing (or not providing, where they are absent) meaningful contractual protection (over and above the reputation of the buyout sponsor) for a given buyout deal structure.

20. Sophisticated buyout lawyers would know all of this, and where they represent targets, would seek to protect their clients by seeking guarantees and third-party beneficiary rights. These protections would be meaningful in a way that a specific performance right against shell entities would not. Here, URI indisputably sought and obtained the right to up to a $100 million reverse termination fee guaranteed by

Cerberus Partners, L.P., while giving up on third-party beneficiary rights in the equity commitment letter from Cerberus Capital Management, L.P.[5] and agreeing to the explicit limitations on liability in Section 8.2(e) of the URI Deal merger agreement, the Limited Guarantee, and the Equity Commitment Letter, which were all executed together and cross-reference one another.

21. From the buyout sponsor's side, pressure by targets to provide guarantees and third-party beneficiary rights led to the rapid spread over the past few years of the so-called "reverse termination fee," providing buyout shell entities and buyout sponsors alike with certainty as to what their real financial exposure would be in the event the buyout was not consummated by the buyout shell entities. Those fees, which are now very typical in large buyouts, generally backed by sponsor guarantees, customarily have the effect of letting a buyout sponsor walk away from a transaction in return for payment of a fixed fee, in cash, and provide targets with a clear remedy as well, as with liquidated damages clauses more generally. It is well understood in the market that the practical effect of a reverse termination fee is to permit the buyer to walk away from the transaction upon payment of the fee. As counsel to URI has written: "A buyer's agreement to a fee provision of this nature therefore should not be viewed as a purely one-sided concession by the buyer, ***because the buyer in this construct can pay a sum certain to walk away from the transaction***."[6]

[5] "There is no express or implied intention to benefit any third party including, without limitation, the Company [i.e., URI] .... Under no circumstances shall the Equity Sponsor be liable for any costs or damages ... to any Person, including the Parent and the Company, in respect of this Equity Commitment Letter; and any claims with respect to the transactions contemplated by the Merger Agreement or this Equity Commitment Letter shall be made only pursuant to the Guarantee to the extent applicable." Letter dated 7/22/07 from Cerberus Capital Management, L.P. to RAM Holdings, Inc., at 1.

[6] Sorkin and Swedenburg, supra note 4, at 5 (emphasis added).

22. The valuable certainty provided by these innovations – for both buyout sponsor and target – would not exist if every time a buyout sponsor sought to pay a reverse termination fee instead of completing a buyout the target could pursue the remedy of specific performance. Put differently, the deal-enhancing value of reverse termination fees would be greatly undermined if the target had available to it the remedy of specific performance.

23. Notably, the characterization of reverse termination fees by URI's counsel as providing sponsors with the ability "to walk away" from a buyout was specifically applied to buyouts in which specific performance provisions enforceable against the buyer can be found. For example, counsel to URI cited the 2005 buyout of Neiman Marcus as one of the deals containing a provision permitting a buyer to "pay a sum certain to walk away from the transaction." Yet Section 9.10 of that agreement contained a specific performance clause enforceable against the buyer shell entities – and it even lacked the "subject to" cross-reference to the liability cap that is present in the URI Deal merger agreement. Nevertheless, counsel to URI did not qualify its characterization of reverse termination fees by reference to this separate provision – and its omission was not likely due to ignorance of the specific performance provision, since it was the same law firm (Simpson Thacher) that was counsel to Neiman Marcus in that buyout. Nor was there any explicit provision in that agreement for the buyer shell entities to terminate the agreement absent breach, change in the target's board recommendation of the deal, or the passing of a drop-dead date.

24. In sum, buyout deal structures have developed such that buyout sponsors are now more at risk than in the past for liability due to non-consummation by buyout shell entities, and targets less at risk. But both buyout sponsors and targets have developed the tool of reverse termination fees to limit and specify that risk. Targets have commonly accepted buyout offers and deal structures that cap the sponsor's exposure and thus allow buyout sponsors to pay a reverse termination fee and walk away from a buyout. Nothing about the URI Buyout – assuming the interpretation of the related agreements advanced by the RAM Entities – is unique or unusual, or would have been irrational or absurd for URI to accept. Rather, the URI Deal was consistent with industry customs and practices.

IV. Customs and Practices of Drafting in M&A Negotiations

25. Buyouts are more complex than most M&A transactions, and a typical buyout negotiation involves simultaneous drafting and negotiation of multiple agreements. Because of the involvement of banks and other entities providing financing, there are also a relatively large number of parties and lawyers who must reach agreement on the terms of the contracts before they can be executed. Because of the complexity, difficulty and time pressure under which buyout agreements are negotiated, negotiations are expensive for the parties overall.

26. As a result of the foregoing, parties to buyout negotiations have powerful reasons (even more powerful than may be the case generally in contract negotiations) to economize on time and expense. One of the ways that the parties commonly economize on time and costs is to not attempt to review every provision of every

related agreement every time a new change is made, particularly when documents are in the final stages of negotiation. Rather, they rely on succinct but legal terms of art to achieve what is, in essence, "editing" of the entirety of a document with minimal change. Among the terms of art customarily relied upon are phrases such as "subject to" or "notwithstanding." These phrases allow the parties to specify that one phrase or provision will take precedence over others, and thus avoid the need to attempt to synthesize every provision of every related agreement that is or may be partly or wholly in conflict with the provision in question.

27. Another reason that such legal drafting techniques are used is they reduce the amount of blacklining and editing that must be reviewed by the numerous parties who must approve and sign off on the final documentation. If, for example, drafters can add a single sentence that contains the phrase "subject to" or "notwithstanding," the various interested parties (banks, bank lawyers, managers, target lawyers, investment banks, their lawyers, buyout sponsors, their lawyers, co-investors, their lawyers, etc.) can simply look at the one sentence to see the meaning of the change. If, on the other hand, a sentence is added while other sentences are modified or deleted to reflect the meaning of the new sentence and eliminate any potential apparent conflicts, more blacklining, on more pages, will have to be reviewed and evaluated by each party. In my practice (and as an occasional participant in contracting as a principal), I have on many occasions attempted to minimize the number of changes, and to minimize the number of pages on which marked changes would be made, and one way to do that was to use "subject to" or "notwithstanding" terminology.

28. Having habituated themselves to these drafting techniques, deal attorneys rely upon them even when a given potential conflict in contract provisions is known and clear, or when it would not be particularly expensive or time-consuming to redraft other potentially conflicting provisions of the contract.

29. The common understanding among deal lawyers of how these phrases are used is believed by deal lawyers to eliminate ambiguity when potentially conflicting provisions are interpreted. As a matter of custom, they rely on that interpretive certainty – that depends on giving effect to phrases such as "subject to" or "notwithstanding" – in drafting and negotiating contracts.

Signed this 6th day of December 2007,

Professor John C. Coates IV