MEMO TO THE PARTNER

ARTICLES OF AMENDMENT FOR TN COMPANY, INC.

JORDANA K. NELSON*

TO: Law Firm Partner
FROM: Jordana K. Nelson
RE: Articles of Amendment for TN Company, Inc.

I. GENERAL

I attach for your review a draft of the mandatory conversion provision to be included in TN Company, Inc.'s (the "Company") articles of amendment establishing a new class of preferred stock. I also attach a glossary of terms used in the draft provision. This glossary should be incorporated into the definition section of the final articles of amendment. Terms used and not defined in this memorandum have the meanings ascribed to them in the glossary. This memorandum explains the context of the transaction, my drafting choices, and the relationship between the two. Various associates are currently drafting the other provisions of the articles of amendment. I reference those other provisions both in this memorandum and in the mandatory conversion provision.

II. TRANSACTIONAL CONTEXT

The Company is a privately held Tennessee corporation. Five people currently hold shares in the Company; none holds more than fifty percent of the Company's outstanding common stock. Currently, the Company owns three restaurants in Memphis, Tennessee. Due to the success of these restaurants, the Company is considering opportunities to expand its business within the State of Tennessee. However, expansion of the business requires additional capital.

Each of the five current shareholders initially contributed between $70,000 and $100,000 to the Company; those initial contributions were expended primarily on the start-up costs of the Company. The Company has approximately $500,000 of outstanding debt, consisting primarily of ground leases and the cost of acquiring equipment for the restaurants.

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The Company currently has one class of equity securities outstanding. However, authorized capitalization includes 50,000 shares of common stock, with a par value of $0.01 per share and 100,000 shares of preferred stock, par value $0.01 per share, which may be issued in series designated by the Board of Directors of the Company (the "Board") in resolutions.

The Board has considered issuing additional debt in order to raise capital for expansion of the Company's business. However, issuing additional debt would potentially over-leverage the Company's assets. Rather than issuing additional debt, the Board currently plans to create a new class of preferred stock, the Series A Cumulative Convertible Preferred Stock, par value $0.01 per share (the "Series A"), which would be created under blank check authority in the Company's charter. The Series A will provide a vehicle for the Company to raise capital to finance the expansion of its business and will spread the risk of expansion to more investors.

Preferred stock is "almost the universal security of choice for venture capital firms investing in U.S. start-up companies."[1] Because preferred stock enjoys a priority over common stock upon liquidation, preferred stock may be more attractive to investors than common stock. The potential for preferred dividends adds to the attraction of issuing preferred stock as a means to raise capital. However, the Board has bigger plans for the Company. In order to expand the business beyond Tennessee, the Board anticipates either a public offering of the Company's stock or entering into some form of business combination with another corporation. Accordingly, one of the Board's largest concerns is the risk of litigation with its existing security holders if either of these transactions takes place.

Because the Board anticipates either a public offering of the Company's stock or a business combination at some point in the future, the Board must retain the ability to alter the Company's capitalization to make it attractive to an underwriter or to an acquisition partner. Therefore, tension exists between the Company's immediate need to create a class of preferred stock attractive to investors and the future need to create a capital structure attractive to an underwriter or acquisition partner.

The most recent similar preferred stock financing transaction that this firm contemplated involved a Delaware corporation that is also in the restaurant business. That corporation, DE Company, Inc., also anticipated either a public offering of

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[1] Kenneth J. Lebrun, *Making a Private Equity/Venture Capital Investment in Japan: Implementing Techniques Commonly Used in U.S. Transactions*, 23 U. PA. J. INT'L. ECON. L. 213, 217 (2002).

common stock or a business combination at some point after its series of preferred stock was issued. At your request, I have drafted the Company's certificate of amendment based upon the certificate of designation we drafted for the DE Company, Inc., transaction.

III. ISSUES

In drafting the conversion option for the Series A, I had to resolve a number of drafting issues. The three most important issues with which I grappled are set forth and described in brief below.

A. How can the Company balance its need for flexibility as to future transactions with the Series A shareholders' need for certainty in their investments?

I considered three types of conversion provisions: mandatory (upon the occurrence of an event or other condition);[2] at the option of the holder;[3] and at the option of the board.[4] The mandatory conversion provision favors neither the board nor the holders and offers no flexibility to either party. A provision permitting conversion at the option of the holder effectively limits the power of the board. Where, as here, future plans for the capitalization of an issuer require its board to retain some flexibility, a paragraph providing for mandatory conversion at the option of the board is the most appropriate provision.

B. What event(s) or transaction(s) should trigger the Board's conversion option?

Based on the Company's long-term business expansion goals and its likely sources of future capital, a public offering of the Company's common stock and a

[2] A mandatory conversion provision provides that upon a stated event or occurrence, the preferred stock automatically will be converted into common stock. *See* DEL. CODE ANN. tit. 8, § 151(e) (2005); TENN. CODE ANN. § 48-16-101(c)(2)(A) (2005).

[3] A provision permitting conversion at the option of the holder provides that upon a stated event or occurrence, the holders have the option of converting their preferred stock into common stock, subject to the other terms and provisions of the preferred stock. *See* DEL. CODE ANN. tit. 8, § 151(e) (2005); TENN. CODE ANN. § 48-16-101(c)(2)(A) (2005).

[4] A provision permitting conversion at the option of the board provides that upon a stated event or occurrence, the board will have the option of requiring preferred stockholders to convert their shares of preferred stock into common stock. *See* DEL. CODE ANN. tit. 8, § 151(e) (2005); TENN. CODE ANN. § 48-16-101(c)(2)(A) (2005).

change of control of the Company each should trigger the Board's option to require conversion of the Series A.

C. How should "change of control" be defined for purposes of the conversion trigger?

Various events and transactions constitute changes in control of a corporation. Although the language in our firm's precedent document, a certificate of designation for a series of preferred stock issued by a Delaware corporation, is a competent place to start, the definition in that precedent Delaware law document must be checked for compliance with Tennessee law. Moreover, the definitions and types of transactions included in the trigger must be reviewed for inclusiveness and approved by the Company.

IV. ANALYSIS OF SPECIFIC DRAFTING CHOICES

A. Choice of Provision

Because the Company desires to balance its competing needs (attracting investors versus retaining as much flexibility as possible), a provision giving the Board the power to require conversion upon the occurrence of specified events is an appropriate choice.

Under section 48-16-101(c) of the Tennessee Code, a corporation's charter may authorize classes of shares (in addition to the required class of common stock) that "[h]ave special, conditional, or limited voting rights[;]…[a]re redeemable or convertible[;]" entitle their holders to preferences or dividends; or "[h]ave a par value[.]"[5] Section 48-16-101(c)(2)(A), which specifically addresses convertible shares, provides that a corporation's charter may designate that certain classes of shares are convertible "[a]t the option of the corporation, the shareholder, or another person or upon the occurrence of a designated event."[6]

In this case, a mandatory conversion provision is not advantageous to either the board or the holders of preferred stock.[7] Should conversion be disadvantageous

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[5] TENN. CODE ANN. § 48-16-101(c) (2005).

[6] § 48-16-101(c)(2)(A).

[7] However, where a mandatory conversion provision is conditioned only upon an initial public offering, investors and management often agree on mandatory conversion because the offering provides an exit strategy for investors and a single class of stock that is more attractive to underwriters. Lebrun, *supra* note 1, at 220.

for the issuer of the preferred stock or the investors, it may be difficult or impossible to prevent the mandatory conversion from occurring.

A provision allowing for conversion at the option of the holder is most attractive to investors, because the holder exerts total control over whether the preferred stock is converted to common stock. While this type of provision severely limits the board's control and flexibility, it is very attractive to investors.

A preferred stock term providing for conversion at the option of the board with no contingency event is clearly most attractive to a board. However, if the board exerts total control over conversion of a series of preferred stock, the preferences of the preferred stock over the common stock are constantly at risk. The possibility of arbitrary forced conversion is unattractive to investors.

The type of provision that I chose to draft provides the holders of the Series A some protection by conditioning the Board's option to require conversion on the Board's approval of a Qualified Public Offering or a Change of Control. The Board retains some degree of flexibility by having the option to require conversion in these limited, anticipated circumstances. This type of provision favors the Board, but because of the long-term plans for the Company (which are being disclosed to investors in the Series A in connection with the solicitation by the Company of their investment in the Company), this level of control by the Board is warranted.

B. The Triggering Transactions

Any number of events could be used to trigger the Board's option to require conversion. However, a Qualified Public Offering and a Change of Control are the most appropriate triggering events for the Company. Additionally, these transactions are common triggers for optional conversion rights in preferred stock of this kind.

Most preferred stock terms that I reviewed dealt with mandatory conversion in the event of an initial public offering or a change of control, but not both. In many industries, a corporation anticipates either an initial public offering or a change of control. However, the "chain" restaurant industry appears to function differently. Many "concept" restaurants begin in the same manner as the Company's restaurants; the founders develop the concept and open a few restaurants in one city or state. If the concept appears successful, the founders may try either to expand the business themselves or sell the existing locations and concept to an established group to be developed. For example, Panera Bread Company began when Au Bon Pain Company, Inc., an already established chain of bakery-cafes on the east coast, "purchased…the Saint Louis Bread Company, a chain of [twenty] bakery-cafes

located in" St. Louis, Missouri.[8] The concept of St. Louis Bread Company was refined and renamed Panera Bread Company.[9]

The Panera Bread Company, through franchising and company-owned stores, now boasts 825 bakery-cafes in 35 states.[10] In contrast, P.F. Chang's China Bistro, Inc., which was founded in 1993, expanded its restaurant concept on its own. Ultimately, P.F. Chang's China Bistro, Inc., was able to offer its common stock to the investing public as a Nasdaq National Market System security in 1998.[11] As of early 2006, P.F. Chang's China Bistro, Inc., owned and operated 115 bistros in 32 states.[12]

The Board is attempting to raise capital to expand the Company's restaurant concept on a local level. It hopes that the Company's success at the local level will enable the Company to further expand its restaurant concept. However, the Board is unsure of the direction the Company will take in financing any future expansion. Therefore, the Board wants to preserve the option either to (a) undertake a public offering of the Company's common stock or (b) approve or accede to a change of control of the Company.

In the event that the Company elects to initiate a public offering of its common stock, it will most likely offer the stock on a "firm commitment" basis. In a firm commitment offering, an underwriter purchases the offering corporation's stock and then distributes that stock to the investing public.[13] Companies offering their stock to the investing public for the first time often have the most difficulty procuring an underwriter.[14] Most underwriters prefer to work with an issuer

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[8] Panera Bread, *Company Overview, at* http://www.panerabread.com/about_co_history.aspx (last visited Feb. 27, 2006).

[9] *Id.*

[10] *Id.*

[11] NASDAQ National Market Securities, *at* http://www.nasdaq.com/asp/symbols.asp?exchange=NNM&start=P&Type=O (last visited Feb. 27, 2006).

[12] P.F. Chang's China Bistro, *Corporate Overview*, *at* http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=pfcb&script=2100 (last visited Feb. 27, 2006).

[13] Steven J. Gray, *The Initial Underwritten Public Offering*, *in* 1 SECURITIES LAW TECHNIQUES 15-6 (A.A. Sommer, Jr. ed., 2005).

[14] *Id.* at 15-8.

capitalized with only one class of common shares so that the investors enjoy maximum participation in the company's future growth.[15] Accordingly, the option to require conversion in the event of a public offering of the Company's stock may be essential to the Company's later success in procuring an underwriter should that be desirable.

If the Company sells its restaurant concept, thereby causing a change of control, the current shareholders want to ensure that the consideration for the sale is divided fairly among the then-current shareholders. If each shareholder holds common stock of the same class at the time of the change of control, the consideration can be divided simply and equally on a per share basis. Because all the shareholders will be treated equally, the risk of litigation is likely reduced.

In addition to eliminating the costs associated with potential litigation, should the Board determine that a business combination is most advantageous, the reduced risk of litigation should render the Company more attractive to potential acquisition partners.

Conversely, should circumstances dictate that existence of the preferred class of shares is preferable, the Board has retained its right to decline to require conversion of the preferred shares.

C. Definition of "Change of Control"

Perhaps the most important part of the Series A conversion provision are the definitions of triggering transactions, and in particular, the definition of a Change of Control. The certificate of designation of DE Company, Inc., defines a Change of Control as "a merger or consolidation of the Corporation or a sale, transfer, or other disposition of all or substantially all the Corporation's property, assets, or business to another corporation…."

While this definition may be suitable for a Delaware corporation, the language is not suitable for a Tennessee corporation.

1. Which transactions to include in the definition of Change of Control.

Under section 251(a) of the Delaware General Corporation Law, a merger occurs when two or more corporations merge into a single corporation, with the

[15] *Id.* at 15-20 to 15-21.

surviving corporation being any one of the merging corporations.[16] Two or more corporations may also consolidate to form a new corporation.[17] A merger or consolidation must be approved by a majority of the stockholders "entitled to vote thereon[.]"[18] With some exceptions,[19] all stockholders entitled to vote on the merger or consolidation are also entitled to appraisal rights if they do not vote in favor of the transaction and meet the procedural requirements of the appraisal rights statute.[20] Under section 271(a) of the Delaware General Corporation Law, a majority of stockholders must approve the sale, lease, or exchange of "all or substantially all" of a corporation's property or assets.[21] However, in an asset sale transaction, the stockholders are not entitled to appraisal rights under Delaware law.[22]

Under section 48-21-102 of the Tennessee Code, two corporations may merge into one corporation.[23] Unlike Delaware, Tennessee law does not recognize a consolidation as a separate form of transaction.[24] Tennessee law does, however, recognize a share exchange under Tennessee Code section 48-21-103, a transaction

[16] DEL. CODE ANN. tit. 8, § 251(a) (2005).

[17] *Id.*

[18] DEL. CODE ANN. tit. 8, § 251(c) (2005). Under section 212(a) of the Delaware General Corporation Law, "each stockholder shall be entitled to [one] vote for each share of capital stock held by such stockholder." DEL. CODE ANN. tit. 8, § 212(a) (2005). However, this default rule can be varied in the corporation's charter. *Id.*

[19] No appraisal rights are available to the stockholders of corporations that, as of the record date fixed to determine stockholders entitled to notice of and to vote on the merger or consolidation, are "(i) listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or (ii) held by more than 2,000 holders." DEL. CODE ANN. tit. 8, § 262(b)(1) (2005). Additionally, stockholders in a corporation that survives the merger are not entitled to appraisal rights unless the stockholders were required to approve the merger. *Id.*

[20] *Id.* § 262(a)-(b).

[21] *Id.* § 271(a).

[22] *See id.*

[23] TENN. CODE ANN. § 48-21-102 (2005).

[24] However, the Tennessee Code does contemplate and allow for the possibility that a merger may result in the creation of a new entity. *See* TENN. CODE ANN. § 48-21-108(a)(1) (2005).

that is not provided for, by statute or otherwise, under Delaware law.[25] As a default rule under Tennessee law, both a merger and a share exchange must be approved by a majority of the shareholders entitled to vote.[26] Under section 48-22-102(a) of the Tennessee Code, "[a] corporation may sell, lease, exchange, or otherwise dispose of all, or substantially all, of its property (with or without the good will) otherwise than in the usual and regular course of business[.]"[27] Under Tennessee Code section 48-22-102(e), a sale of assets qualifying under section 48-22-102(a) must be approved by a majority of the shareholders entitled to vote thereon.[28] A Tennessee corporation's shareholders have the right to dissent from a merger, share exchange, or disposition of all or substantially all of the corporation's assets otherwise than in the usual and regular course of business and seek an appraisal of their shares only if the shareholders are entitled to vote on such transaction.[29] As is true for Delaware stockholders, Tennessee shareholders may exercise their appraisal rights only if they do not vote for the subject transaction and if they follow the required statutory procedures.[30]

Based on the foregoing differences in Delaware and Tennessee law, at a minimum, the exemplar DE Company, Inc., provision must be revised to delete the reference to a consolidation and add a reference to the possibility of a share exchange transaction, so that the definition addresses a possible merger, share

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[25] *Id.* § 48-21-103.

[26] *Id.* § 48-21-104(c)(2), (f). For purposes of title 48, chapter 21 of the Tennessee Code, which regulates mergers and share exchanges, "'[v]oting shares' means shares that entitle their holders to vote unconditionally in the election of directors." *Id.* § 48-21-101(4). Generally, under Tennessee law, "each outstanding share, regardless of class, is entitled to one…vote on each matter voted on at a shareholders' meeting." *Id.* § 48-17-202(a). "[D]irectors are [generally] elected by a plurality of the votes cast by the shares entitled to vote in the election." *Id.* § 48-17-209(a). However, voting rights may be modified in the corporation's charter. *Id.*

Here, the five holders of the Company's common stock have requested that the preferred shareholders' voting rights be as limited as possible. Therefore, under the articles of amendment, the Series A holders will have no voting rights.

[27] TENN. CODE ANN. § 48-22-102(a) (2005).

[28] § 48-22-102(e).

[29] TENN. CODE ANN. § 48-23-102(a)(1)-(3) (2005). Here, the Series A holders are not entitled to vote on any of the transactions and, therefore, have no dissenters' rights.

[30] § 48-23-202.

exchange, or sale of all or substantially all of the Company's assets other than in the usual and regular course of business.

2. Conversion price applied to each Change of Control transaction.

An additional consideration is whether to treat all of the transactions in the same way with regard to conversion price. In a merger or share exchange, each target corporation shareholder typically receives cash or securities representing an interest in a different corporation. However, following an asset sale, each selling corporation shareholder continues to hold shares in the same corporation; that corporation simply has different assets after the transaction. If the selling corporation does not distribute the proceeds of the asset sale, the shareholders are compensated through any increase in the value of their shares in the selling corporation.

Because the results of each transaction differ, shareholders may receive different benefits based on the type of business combination, or change of control, in which the corporation is a party. The Company could then structure a future change of control in a manner that, in the view of the preferred shareholders, may be less desirable on a financial basis.

The Company's ability to distinguish between transactions is supported by case law. Because Tennessee case law is somewhat undeveloped in the corporate law area, Tennessee courts look to Delaware law, as well as to the corporate law decisions of other states.[31] In *Hariton v. Arco Electronics, Inc.*,[32] the sale of a corporation's assets under section 271 of the Delaware General Corporation Law, followed by a dissolution under section 275 of the Delaware General Corporation Law (and resulting distribution of assets to stockholders) accomplished the same results as a merger would have produced. The plaintiff stockholder argued that the corporation had undergone a *de facto* merger and that the stockholders should be treated as they would be in a merger (i.e., that they should be given appraisal rights).[33]

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[31] *See* Bayberry Assocs. v. Jones, 1988 Tenn. App. LEXIS 589, at *14 n.8 (Tenn. Ct. App. Nov. 9, 1988), *vacated on other grounds*, 783 S.W.2d 553 (Tenn. 1990).

[32] 182 A.2d 22 (Del. Ch. 1962), *aff'd*, 188 A.2d 123 (Del. 1963).

[33] *Id.* at 24.

However, the *Hariton* court held that when a corporation acts on the authority of a statute, the validity of the action is dependent only upon that statute.[34]

Despite the *Hariton* holding, which is favorable to corporations, one of our client's goals is to reduce the risk of litigation. Although the holding and reasoning of the court in *Hariton* is favorable to the Company, not every jurisdiction has followed this holding and reasoning.[35] However, if all transactions are treated equally under the conversion provision, the incentive to litigate the characterization of the transaction is reduced.[36]

3. Whether to define each or any Change of Control transaction.

While reviewing different precedent documents before drafting this provision, I noticed that none of the transactions included in the definition of a Change of Control were themselves defined. At first blush, the omission of such definitions appears to be careless drafting. After all, countless cases exist where the board of directors argues that a transaction does not constitute a merger within the meaning of the certificate of designation and the shareholders insist that the transaction is, indeed, a merger (or vice versa).[37]

However, after careful consideration, I also have omitted definitions for the individual transactions included in the Change of Control definition. If the different

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[34] *Id.* at 27. The doctrine described in *Hariton* is commonly referred to as the doctrine of independent legal significance or equal dignity. *See, e.g.,* Langfelder v. Universal Laboratories, Inc., 68 F. Supp. 209, 211 (D. Del. 1946); Elliott Assocs., L.P. v. Avatex Corp., 715 A.2d 843, 845 (Del. 1998); Thorpe v. CERBCO, 676 A.2d 436, 444 (Del. 1946).

[35] *See, e.g.,* Applestein v. United Bd. & Carton Corp., 159 A.2d 146, 156 (N.J. Super. Ct. Ch. Div. 1960) (holding that "it is proper to disregard the [f]orm of a sale or purchase of assets transaction[ ] when its characteristics are virtually identical to those of a statutory merger or consolidation for the purpose of insuring [sic] dissenting stockholders their appraisal rights").

[36] It should be noted that the holders of the Series A will have only limited dissenters' rights. Under Tennessee law, a shareholder's right to dissent from a corporate action is generally limited to situations where the shareholder is entitled to vote on the corporate action. *See* TENN. CODE ANN. § 48-23-102 (2005). Since the Series A will not have voting rights on any of the transactions included in the change of control definition, *see supra* notes 26 and 29, this basis for litigation has been foreclosed.

[37] *See, e.g.*, *Hariton*, 182 A.2d at 24 (plaintiff stockholder arguing that the corporation underwent a *de facto* merger); Rauch v. RCA Corporation, 861 F.2d 29, 30 (plaintiff stockholder arguing "that the merger constituted a 'liquidation or dissolution or winding up of RCA and a redemption of the [Preferred Stock]'").

transactions are defined in the articles of amendment, the Company may be limited in how it can structure each type of transaction. This restriction of the Company's structuring capability may, in turn, limit its bargaining power when negotiating with third parties that may be interested in engaging in a business combination transaction with the Company. I determined that the risk of litigation on the transactional definitions is outweighed by the need for flexibility on the part of the Board in negotiating future transactions. However, as discussed below, I have given more careful consideration to the decision of defining what constitutes a sale of "substantially all" the assets of the Company, since this type of transaction presents unique issues.

Instead of including definitions, I have included references to the appropriate statutes for each transaction. These references, although unconventional in corporate finance drafting, lend some additional precision to the document. So long as the Company has authority to authorize each transaction under the appropriate statute, there should be little argument regarding the characterization of the transaction.

4. Defining "substantially all" for purposes of the sale of assets Change of Control trigger.

The asset sale portion of the Change of Control definition presents a unique issue. Although mergers and share exchange transactions may not always be obvious to a court without a definition or statutory reference, they are significantly easier to identify than sales of substantially all the assets. Section 48-22-102(a) of the Tennessee Code requires shareholder approval only when a corporation disposes of "all, or substantially all," of its assets other "than in the usual and regular course" of its business.[38] However, the statute provides no guidance for determining when "substantially all" of a corporation's assets have been disposed of.

Notably, the Model Business Corporation Act (the "MBCA"), on which the Tennessee Business Corporation Act is modeled, does not include the "substantially all" language. Instead, section 12.02(a) of the current version of the MBCA requires shareholder approval for a disposition of assets "if the disposition would leave the corporation without a significant continuing business activity."[39] Section 12.02(a) also provides that

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[38] TENN. CODE ANN. § 48-22-102(a) (2005).

[39] MODEL BUS. CORP. ACT § 12.02(a) (2004).

> [i]f a corporation retains a business activity that represented at least 25 percent of total assets at the end of the most recently completed fiscal year, and 25 percent of either income from continuing operations before taxes or revenues from continuing operations for that fiscal year, in each case of the corporation and its subsidiaries on a consolidated basis, the corporation will conclusively be deemed to have retained a significant continuing business activity.[40]

While this model statute is instructive, the Tennessee legislature has not yet chosen to adopt it. Therefore, it is not the definition of "substantially all" in Tennessee.

Tennessee courts have not addressed this issue in a reported opinion. Therefore, we must look again to Delaware law and the law of other jurisdictions.[41] Delaware courts have considered this issue on many occasions. In *Gimbel v. Signal Companies, Inc.*,[42] the court found that all, or substantially all, of a corporation's assets are sold "[i]f the sale is of assets quantitatively vital to the operation of the corporation *and*…substantially affects the existence and purpose of the corporation[.]".[43] In applying *Gimbel*, Delaware courts appear to stress the qualitative prong of the test by analyzing the continuing effect of the sale on the ongoing corporate enterprise.[44]

Apparently, there is no single, agreed-upon definition of "substantially all." Moreover, if "substantially all" is defined in the document, the same limitations are imposed on the Board as would be imposed by defining "merger." Even here, the risk of litigation on the meaning of "substantially all" is outweighed by the Board's

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[40] *Id.* It should be noted that the previous version of the MBCA did not include such a specific definition; that earlier version of the MBCA contained language similar to the Tennessee Business Corporation Act.

[41] *See supra* text accompanying note 31.

[42] 316 A.2d 599 (Del. Ch. 1974).

[43] *Id.* at 606 (emphasis added), *quoted in* DAVID A. DREXLER ET AL., 2 DELAWARE CORPORATION LAW AND PRACTICE § 37.03 (Janet C. Foster et al. eds., 2005).

[44] DREXLER ET AL., *supra* note 43, at § 37.03.

need for flexibility. This conclusion is supported by the fact that I found no precedent documents that defined "substantially all."

D. Minor Drafting Choices

To make the mandatory conversion provision easier to read, I reformatted the provision into subsections. I changed all references to "stockholders" to "shareholders" (In Delaware, the preferred statutory term is "stockholders," while in Tennessee the preferred statutory term is "shareholders").[45] I used the same definition of a Qualified Initial Public Offering as was used in the DE Company, Inc., precedent document. The $10,000,000 requirement is most likely the smallest offering of stock that an underwriter would accept.[46]

I also have bracketed the language following each statutory reference. I realize that "hedging" language[47] must be included in the document, but any suggestions for consolidating this language in one part of the provision would be appreciated.

Section 6(b) of the mandatory conversion provision refers to the general conversion procedures set forth in Section 7 of the articles of amendment. As you are aware, other associates in the firm currently are drafting that provision.

I appreciate the opportunity to work on this offering. Please let me know if you have any questions on this memorandum or the attached draft provision.

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[45] *See* DEL. CODE ANN. tit. 8, §§ 101-398 (2005); TENN. CODE ANN. § 48-11-201(25) (2005).

[46] Richard A. Mann, et al., *Starting From Scratch: A Lawyer's Guide To Representing A Start-Up Company*, 56 ARK. L. REV. 773, 842 n.500 (2004) (classifying a $10,000,000 offering as a small offering); Jeffrey A. Brill, Note, *"Testing the Waters" - The SEC's Feet Go From Wet to Cold*, 83 CORNELL L. REV. 464, 545 (1998) ("IPOs above Regulation A's ceiling of $ 5 million, but below $ 10 million are often too small to attract underwriters, particularly larger ones with established reputations.").

[47] "Hedging" language is included after a statutory reference and refers to any amendments to the statute and successor statutes so that the statutory reference does not become obsolete. *See* Caroline N. Brown, *U.C.C. Revised Article 9: The Transition Rules*, 79 N.C. L. Rev. 993, 1000-03 (2001) (discussing the disadvantages of such language in connection with security agreements referencing Article 9 of the Uniform Commercial Code).

GLOSSARY OF DEFINED TERMS

"Board of Directors" means the board of directors of the Company.

"Business Day" means any day that is not a Saturday or Sunday or a day on which banks are required or permitted to be closed in the State of Tennessee.

"Change of Control" is defined in Section 6(a)(ii).

"Common Stock" means the common stock, par value $0.01 per share, of the Company.

"Company" means TN Company, Inc., a Tennessee corporation.

"Holder" means a registered holder of Series A shares.

"Initial Issue Date" means the date on which shares of Series A are first issued by the Company.

"Notice of Conversion" means a conversion notice in the form attached as Exhibit A.

"Qualified Initial Public Offering" is defined in Section 6(a)(i).

"Series A" means the Series A Convertible Preferred Stock, par value $0.01 per share, of the Company.

DRAFT OF MANDATORY CONVERSION PROVISION

6. Conversion at the Company's Election.

(a) For purposes of this Section 6:

(i) "Qualified Initial Public Offering" means an underwritten public offering of shares of the Common Stock under an effective registration statement under the Securities Act of 1933, as amended, (x) the aggregate gross proceeds of which equal or exceed $10,000,000 and (y) the per share offering price of which equals or exceeds $10.00; provided, however, that the per share offering price referred to in clause (y) shall be adjusted to reflect the effect of any stock split or any subdivision, reclassification, combination, or like event affecting the outstanding shares of Common Stock and occurring after the Initial Issue Date; and

(ii) "Change of Control" means: (x) the sale, lease, exchange, or other disposition of all, or substantially all, of the Company's property (with or without the associated good will) otherwise than in the usual and regular course of business as the same is described in Tennessee Code Annotated § 48-22-102 [or any successor statute, as the same may be in effect from time to time]; (y) a merger of the Company under Tennessee Code Annotated § 48-21-102 [or any successor statute, as the same may be in effect from time to time]; or (z) a share exchange under Tennessee Code Annotated § 48-21-103 [or any successor statute, as the same may be in effect from time to time].

(b) The Company may call for the conversion of all or any portion of the Series A upon the occurrence of either of the following:

(i) approval by the Board of a Qualified Initial Public Offering; or

(ii) approval by the Board and by shareholders of the Company entitled to vote of a transaction that results in a Change of Control.

(c) A call for conversion under Section 6(b)(i) shall become effective immediately prior to effectiveness of the registration statement contemplated by Section 6(a)(i) in the manner set forth in Section 7.[48]

[48] Section 7 details the general conversion procedures for the Series A. As I indicated in my memorandum to the Partner, that Section is being drafted by another associate.

(d) A call for conversion under Section 6(b)(ii) shall become effective on the date immediately prior to the time at which the Change of Control becomes effective in the manner set forth in Section 7.