

MEDIA DERIVATIVES, INC. BACKGROUND PAPER

This Background Paper provides an overview of Media Derivatives, Inc. (“MDEX”), including its structure, operations, trading system and contracts, along with a brief description of the motion picture industry for which the MDEX contracts are designed as risk management tools.

MDEX and Veriana Networks, Inc.

MDEX was formed in April 2007 to operate as an electronic exchange for contracts based on movie box office revenues. It is a Delaware corporation and wholly-owned subsidiary of Veriana Networks, Inc. (“Veriana”), a privately-held media and technology company formed in 2007 as a Delaware corporation. Veriana has elected to open investment opportunity to other individuals and entities outside of Veriana whom the company believes to be valued partners.

MDEX currently has a four person Board of Directors, one of whom is also President & CEO of Veriana. Two of the remaining directors are investors in, and directors of, Veriana. The remaining director is independent with extensive experience in the exchange community. Prior to the launch of the exchange and in accordance with the MDEX rules, the Board of Directors will constitute eleven members, four of whom will be public directors.

Business Model and Vision

The production and distribution of major motion pictures involves a variety of substantial risks. These risks are:

- Production Risk – The risk that the movie is not produced on schedule or is not produced at all.
- Budget Risk – The risk that the production of the movie exceeds its budget.
- Release Schedule Risk – The risk that the movie is not released on time and is late to market.
- Revenue Risk – The risk that the movie underperforms at market, and does not generate the expected level of revenues.

MDEX is building the infrastructure to enable the risk transfer of these risks from the producers, studios, theaters, and financiers/film funds to a community of speculators willing to assume these risks in return for being paid risk premiums. Opportunities exist for speculators to be fairly compensated for assuming these risks, while at the same time providing the producers and other segments of the industry with an effective risk mitigation opportunity at a reasonable price. As in all futures markets, there is a potential win-win scenario where everybody is better off through enabling the production risk to be sold to a community of speculators willing to assume these risks in exchange for receiving a suitable risk premium.

The exchange has been built with this vision in mind from inception.

Regulatory and Clearing Aspects

MDEX has entered into a Regulatory Services Agreement with the National Futures Association (“NFA”) pursuant to which NFA will perform regulatory services. MDEX will use the Minneapolis Grain Exchange (“Clearing House”) to clear transactions on its markets, and has entered into a Clearing Services Agreement with the Clearing House.

Motion Picture Industry

MDEX has developed formats and requirements for listing two types of contracts – binary options and collared futures – based on domestic box office revenues for individual motion pictures that are rated by the Motion Picture Association of America (“MPAA”). Limiting contracts to MPAA-rated movies means that the movie must open domestically on at least 600 movie screens. The contracts will provide a unique means for different segments of the industry to manage cost and revenue risks associated with the theatrical release of major motion pictures. The primary financial risk stems from wildly uncertain projections for demand, i.e., box office revenues.

The process to develop, produce, distribute and market a movie can take several years. Financing is typically provided in-house by the major production studios and by investors. The total costs can be significant, averaging \$107 million per movie, with advertising costs for a mass-media campaign equally 50% of the production budget.

Movies are distributed for theatrical release through exhibition contracts with movie theaters. The studio and theater owner divide the revenues from ticket sales, typically using a sliding scale formula, where the studio’s share is larger in the initial weeks and declines over time. Thus, the value of an exhibition contract to each party will depend upon the revenue stream generated by the movie or movies it covers.

According to the MPAA, motion picture theater releases in 2007 grossed over \$9.6 billion in revenues domestically and over \$26 billion globally. Approximately 200 - 225 MPAA-rated movies are released each year, but a small percentage accounts for the bulk of the revenues.

MDEX Contracts and Risk Management Function

MDEX and Veriana have identified a need for risk management tools for the motion picture industry. MDEX plans to offer cash-settled contracts based on domestic gross box office revenues for stipulated periods (e.g. opening weekend and 4-week periods) on individual motion pictures in the form of binary option contracts and collared futures contracts. These box office revenue period contracts will settle based on the gross box office revenues reported by the studio or distributor for the motion picture for dissemination through established providers of such market data.

MDEX has negotiated agreements with Nash Information Services and Rentrak Corporation to provide the reported box office revenue data on which final settlement of the futures upon expiration and exercise value of the options will be determined. Both of these companies are recognized as leading providers of market data on movie industry revenues. Both also have arrangements with the movie studios and theatres to receive and disseminate such data.

The box office revenue period contracts are designed as risk management tools. Movie directors, producers, movie investors and advertisers could use the contacts to hedge the downside risk of their investments. For example, opening weekend box office receipts affect costs and revenues for domestic movie distributors and theater owners, and U.S. domestic box office receipts affect costs and revenues for foreign distributors, creating conditions for natural short hedgers.

Market Operations: Trading System, System Access, Trading Hours and Order Types

MDEX will offer its contracts for trading on an electronic trading system that it designed and developed internally (the “Trading System”). The Trading System is undergoing continuous testing for compliance with the standards for screen-based trading systems developed and published by the International Organization of Securities Commissions. MDEX plans to commission functionality testing and will commission a SAS 70 audit and security testing of the Trading System.

Clearing Members of the Clearing House are eligible to become Clearing Members of MDEX. An MDEX Clearing Member will be required to establish and maintain access to the Trading System through a web-based access application offered by MDEX or through a direct connection to the Trading System using leased lines, VPN connections or other acceptable means.

MDEX Clearing Members will authorize all users. At launch, it is envisioned that access to the Trading System will primarily be through the MDEX web-based access application, which Clearing Members may also make available to their customers. MDEX Clearing Members may also permit customers to transmit orders to the Trading System over other automated order routing systems. An MDEX Clearing Member may also authorize and sponsor a market user to have its own direct connection using leased lines or VPN connections as a Direct Market Access Participant. The number of Direct Market Access Participants is expected to be small, at least initially. Direct Market Access Participants, along with MDEX Clearing Members and their respective Registered Users, will be subject to MDEX rules through user access agreements.

The MDEX Board will set the trading hours for each contract. Currently, it is planned that contracts will be listed for trading Monday through Friday from 8:30 am CST to 2:30 pm CST.

The Trading System accepts limit orders, but not market orders. Each order must include a time designation as a session order, good-till-date order or good-till-cancelled order. A session order remains open on the Trading System throughout a trading session so long as it is unexecuted or uncancelled, subject to automatic cancellation when the Clearing Member’s login application is disconnected. A good-till-date order remains open on the Trading System so long as it is unexecuted or uncancelled, through the end of the trading session for the date specified on the order. A good-till-cancelled order remains open on the Trading System, so long as it is unexecuted or uncancelled, through the end of the trading session on the last trading day for the applicable contract. Prior to its execution, an active order may be cancelled or modified to reduce the quantity.

The Trading System provides a single opening price for each contract or binary strike price during the trading session based upon all orders entered prior to the designated opening time. Absent a market at the open, the previous settlement price will serve as the opening price.

Market Users

As mentioned, the contracts are designed as risk management tools for the movie industry. MDEX hopes to attract directors, producers, movie investors, advertisers, distributors and theater owners as hedging market users. MDEX believes that its contracts will also attract both institutional and retail participants in the futures markets.

As explained above, market users that are Clearing Members may access the Trading System through MDEX's web-based access or direct connections. Market users that are Direct Market Access Participants will have direct connections to the Trading System. Market users will access the Trading System as customers through MDEX's web-based access or a Clearing Member's automated order routing system.

Clearing Process

As mentioned, MDEX will use the Minneapolis Grain Exchange to clear transactions on its markets. MDEX has signed a clearing services agreement with the Clearing House.

Under the clearing services agreement, MDEX will provide the Clearing House with cash or U.S. Treasury securities in the amount of \$150,000 that would be immediately available to it in the event of a Clearing Member default involving MDEX contracts. This pledged amount will be increased by at least \$0.10 per cleared contract side, up to \$5,000,000.