

IMAX CORP
Form 10-K/A
November 06, 2007

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
Amendment No. 1 to Form 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
Commission file Number 0-24216
IMAX Corporation
(Exact name of registrant as specified in its charter)**

Canada
(State or other jurisdiction of incorporation or
organization)

98-0140269
(I.R.S. Employer Identification Number)

2525 Speakman Drive, Mississauga, Ontario, Canada
(Address of principal executive offices)

L5K 1B1
(Postal Code)

Registrant's telephone number, including area code: **(905) 403-6500**
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Shares, no par value <i>Securities registered pursuant to Section 12(g) of the Act:</i>	The NASDAQ Stock Market LLC
None (Title of class)	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12B-2 of the Exchange Act.
Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell Company (as defined in Rule 12b-2 of the Act). Yes No

Edgar Filing: IMAX CORP - Form 10-K/A

The aggregate market value of the common shares of the registrant held by non-affiliates of the registrant, computed by reference to the last sale price of such shares as of the close of trading on June 30, 2006 was \$330.23 million (36,051,314 common shares times \$9.16).

As of June 30, 2007, there were 40,288,074, common shares of the registrant outstanding.

Table of Contents

IMAX CORPORATION

EXPLANATORY NOTE TO ANNUAL REPORT ON FORM 10-K/A

IMAX Corporation together with its wholly-owned subsidiaries (the Company) previously announced its intention to restate its consolidated financial statements for the years ended December 31, 2002, 2003, 2004, 2005 and 2006, and the first six months of 2007. The Company files this Amendment No.1 to its 2006 Annual Report on Form 10-K, (this Form 10-K/A), to reflect the correction of errors that were contained in the Company's 2006 Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission (SEC) on July 20, 2007, (the Original 2006 Form 10-K). The Company also amends portions of its Original 2006 Form 10-K in response to a comment letter received from the SEC. In this Form 10-K/A the Company has corrected certain errors with regard to its lease-related accounting practices as they related to the Company's owned and operated theaters and office facilities, sponsorship revenue at its owned and operated theaters, corrected a revenue recognition error for a transaction in 2002, revised the presentation of discontinued operations in the consolidated statement of cash flows, enhanced disclosures relating to its credit facilities and revenue recognition accounting policies, included a signature block in the audit report and additional disclosure in Item 10 that were omitted as a result of a typographical error and updated the disclosure with respect to its legal proceedings and management cease trade order. The Company is also updating Item 1A. Risk Factors and revising Item 9A. Controls and Procedures in connection with such changes.

The consolidated statements of operations, shareholders' equity (deficit) and cash flows for the years ended December 31, 2006, 2005 and 2004, and the consolidated balance sheets as of December 31, 2006 and 2005, including the applicable notes, contained in this Form 10-K/A, have been restated. The Company has also included in this report restated unaudited consolidated financial information for each of the quarters of 2006 and 2005. The Company has also included in this report restated summary and selected financial information for the years ended December 31, 2003 and 2002.

In the Original 2006 Form 10-K, the Company restated its consolidated statements of operations, shareholders' equity (deficit) and cash flows for the years ended December 31, 2005 and 2004, and the consolidated balance sheet as of December 31, 2005, including the applicable notes. The Company also included in the Original 2006 Form 10-K restated unaudited consolidated financial information for each of the first three quarters of 2006 and each of the quarters of 2005. The Company also included in the Original 2006 Form 10-K a restated summary and selected financial information for the years ended December 31, 2003 and 2002.

For a description of the restatements, see note 4 to the accompanying audited consolidated financial statements in Item 8, Item 6. Selected Financial Data and Restatement of Previously Issued Financial Statements and Material Weaknesses in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation contained in this Form 10-K/A.

This amendment reflects the changes discussed above. All other information is unchanged and reflects the disclosures made at the time of the original filing on July 20, 2007.

The items amended are as follows:

- Part I, Item 1A. Risk Factors
- Part I, Item 1B. Unresolved Staff Comments
- Part I, Item 3. Legal Proceedings
- Part II, Item 6. Selected Financial Data
- Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
- Part II, Item 8. Financial Statements and Supplementary Data
- Part II, Item 9A. Controls and Procedures
- Part II, Item 10. Directors, Executive Officers and Corporate Governance
- Part IV, Item 15. Exhibits and Financial Statement Schedule

The information included in this Form 10-K/A has not been updated for any events that have occurred subsequent to the Original 2006 Form 10-K filed on July 20, 2007. For a discussion of events and developments subsequent to December 31, 2006, see the Company's reports filed with the SEC since July 20, 2007.

Table of Contents

IMAX CORPORATION
Amendment No. 1 to Form 10-K
December 31, 2006
Table of Contents

	Page
<u>PART I</u>	
<u>Item 1 Business</u>	5
<u>Item 1A Risk Factors</u>	15
<u>Item 1B Unresolved Staff Comments</u>	26
<u>Item 2 Properties</u>	27
<u>Item 3 Legal Proceedings</u>	27
<u>Item 4 Submission of Matters to a Vote of Security Holders</u>	28
<u>PART II</u>	
<u>Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	29
<u>Item 6 Selected Financial Data</u>	32
<u>Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	45
<u>Item 7A Quantitative and Qualitative Disclosures about Market Risk</u>	74
<u>Item 8 Financial Statements and Supplementary Data</u>	75
<u>Item 9 Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	160
<u>Item 9A Controls and Procedures</u>	160
<u>Item 9B Other Information</u>	165
<u>PART III</u>	
<u>Item 10 Directors, Executive Officers and Corporate Governance</u>	166
<u>Item 11 Executive Compensation</u>	169
<u>Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	181
<u>Item 13 Certain Relationships and Related Transactions, and Director Independence</u>	183
<u>Item 14 Principal Accounting Fees and Services</u>	184
<u>PART IV</u>	
<u>Item 15 Exhibits, Financial Statement Schedules</u>	185
<u>Signatures</u>	189
<u>EX-23</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-31.3</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	
<u>EX-32.3</u>	

Table of Contents**IMAX CORPORATION****EXCHANGE RATE DATA**

Unless otherwise indicated, all dollar amounts in this document are expressed in United States (U.S.) dollars. The following table sets forth, for the periods indicated, certain exchange rates based on the noon buying rate in the City of New York for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate). Such rates quoted are the number of U.S. dollars per one Canadian dollar and are the inverse of rates quoted by the Federal Reserve Bank of New York for Canadian dollars per U.S. \$1.00. The average exchange rate is based on the average of the exchange rates on the last day of each month during such periods. The Noon Buying Rate on December 31, 2006 was U.S. \$0.8582.

	Years ended December 31,				
	2006	2005	2004	2003	2002
Exchange rate at end of period	\$0.8582	\$0.8579	\$0.8310	\$0.7738	\$0.6329
Average exchange rate during period	\$0.8818	\$0.8254	\$0.7682	\$0.7139	\$0.6368
High exchange rate during period	\$0.9100	\$0.8690	\$0.8493	\$0.7738	\$0.6619
Low exchange rate during period	\$0.8528	\$0.7872	\$0.7158	\$0.6349	\$0.6200

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

Certain statements included in this annual report may constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, references to future capital expenditures (including the amount and nature thereof), business and technology strategies and measures to implement strategies, competitive strengths, goals, expansion and growth of business, operations and technology, plans and references to the future success of IMAX Corporation together with its wholly-owned subsidiaries (the Company) and expectations regarding the Company s future operating results. These forward-looking statements are based on certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions and expected future developments, as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform with the expectations and predictions of the Company is subject to a number of risks and uncertainties, including, but not limited to, general economic, market or business conditions; the opportunities (or lack thereof) that may be presented to and pursued by the Company; competitive actions by other companies; U.S. or Canadian regulatory inquiries; conditions in the in-home and out-of-home entertainment industries; changes in laws or regulations; conditions, changes and developments in the commercial exhibition industry; the acceptance of the Company s new technologies (including in particular its transition to digital projection technology); risks associated with investments and operations in foreign jurisdictions and any future international expansion, including those related to economic, political and regulatory policies of local governments and laws and policies of the United States and Canada; the potential impact of increased competition in the markets the Company operates within; and other factors, many of which are beyond the control of the Company. Consequently, all of the forward-looking statements made in this annual report are qualified by these cautionary statements, and actual results or anticipated developments by the Company may not be realized, and even if substantially realized, may not have the expected consequences to, or effects on, the Company. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

IMAX®, IMAX® Dome, IMAX® 3D, IMAX® 3D Dome, *The IMAX Experience*®, *An IMAX Experience*®, IMAX DMR®, DMR®, IMAX MPX®, IMAX think big® and think big® are trademarks and trade names of the Company or its subsidiaries that are registered or otherwise protected under laws of various jurisdictions.

Table of Contents

**IMAX CORPORATION
PART I**

Item 1. Business

GENERAL

IMAX Corporation, together with its wholly-owned subsidiaries (the Company), is one of the world's leading entertainment technology companies, specializing in digital and film-based motion picture technologies and large-format two-dimensional (2D) and three-dimensional (3D) film presentations. The Company's principal business is the design, manufacture, sale and lease of theater systems based on proprietary and patented technology for large-format, 15-perforation film frame, 70mm format (15/70-format) theaters, including commercial theaters, museums and science centers, and destination entertainment sites. The majority of these theaters are operated by third parties. The Company generally does not own IMAX theaters, but licenses the use of its trademarks along with the sale or lease of its equipment. The Company refers to all theaters using the IMAX theater system as IMAX Theaters.

The Company is also engaged in the production, digital re-mastering, post-production and distribution of 15/70-format films, the operation of IMAX theaters and the provision of services in support of IMAX theaters and the IMAX theater network.

The Company believes the IMAX theater network is the most extensive large-format theater network in the world with 284 theaters operating in 40 countries as of December 31, 2006. Of these 284 theaters, 166 are located in commercial locations, such as multiplex complexes, and 118 of them are currently located in institutional locations, such as museums and science centers. While the Company's roots are in the institutional market, the Company believes that the commercial market is potentially significantly larger. To increase the demand for IMAX theater systems, the Company has positioned the IMAX theater network as a new distribution platform for Hollywood blockbuster films. To this end, the Company has developed a technology that allows conventional 35mm movies to be digitally converted to its 15/70-format, has introduced lower cost theater systems designed for multiplex owners, is continuing to build strong relationships with Hollywood studios and commercial exhibition companies and is developing a new digital projector which it believes will result in even more Hollywood features being released to the IMAX network.

IMAX theater systems combine advanced, high-resolution projectors with film handling equipment and automated theater control systems, sound system components and screen components as large as eight stories high (approximately 80 feet) that extend to the edge of a viewer's peripheral vision to create immersive audio-visual experiences. As a result, audiences feel as if they are a part of the on-screen action in a way that is more intense and exciting than in traditional theaters. In addition, the Company's IMAX 3D theater systems combine the same theater systems with 3D images that further increase the audience's feeling of immersion in the film.

In 2002, the Company introduced a technology that can digitally convert live-action 35mm films to its 15/70-format at a modest incremental cost, while meeting the Company's high standards of image and sound quality. The Company believes that this proprietary system, known as IMAX DMR (Digital Re-Mastering), has positioned IMAX theaters as a new release window or distribution platform for Hollywood's biggest event films. As of December 31, 2006, the Company, along with its studio partners, had released 18 IMAX DMR films since 2002. In 2006, the Company released seven films converted through the IMAX DMR process contemporaneous with the releases of the films to conventional 35mm theaters, and released one film co-produced by the Company exclusively for IMAX theaters.

In 2003, the Company introduced IMAX MPX, a new theater system designed specifically for use by commercial multiplex operators. The IMAX MPX system, which is highly automated, was designed to reduce the capital and operating costs required to run an IMAX theater while still offering consumers the image and sound quality of the trademarked experience viewers derive from IMAX theaters known as *The IMAX Experience*. During 2006, the Company signed agreements for 22 IMAX MPX theater systems with North American and international commercial theater exhibitors. Four of the 22 signed IMAX MPX theater system agreements were conditional and such rights to the conditions have now lapsed.

The Company is in the process of developing a digitally-based IMAX projector which would operate without the need for analog film prints. The Company anticipates that its digital projector, which will be targeted to a large portion of its commercial multiplex operators as a replacement for the IMAX MPX projector, will be available for production

and sale by early 2009.

Table of Contents**IMAX CORPORATION****Item 1. Business** (cont d)**GENERAL** (cont d)

The Company's goal is to create a digital product that provides a differentiated experience to moviegoers that is consistent with what they have come to expect from the IMAX brand. The Company believes that transitioning from a film-based platform to a digital platform for a large portion of its customer base is compelling for a number of reasons. The savings to the studios as a result of eliminating film prints are considerable, as the typical cost of an IMAX film print ranges from \$22.5 thousand per 2D print to \$45 thousand per 3D print. Removing those costs will significantly increase the profit of an IMAX release for a studio which, the Company believes, provides more incentive for studios to release their films to IMAX theaters. The Company similarly believes that economics change favorably for its exhibition clients as a result of a digital transition, since lower print costs and the increased programming flexibility that digital delivery provides should allow theaters to program three to four additional IMAX DMR films per year, thereby increasing both customer choice and total box-office revenue. Finally, digital transmission allows for the opportunity to show attractive alternate programming, such as live events like the Super Bowl or World Cup, in the immersive environment of an IMAX theater.

The Company was formed in March 1994 as a result of an amalgamation between WGIM Acquisition Corp. and the former IMAX Corporation (Predecessor IMAX). Predecessor IMAX was incorporated in 1967.

PRODUCT LINES

The Company is the pioneer and leader in the large-format film industry, and believes it is the largest designer and manufacturer of specialty projection and sound system components, and a significant producer and distributor of 15/70-format films, for large-format theaters around the world. The Company's theater systems include a specialized IMAX projector, advanced sound systems and specialty screens. The Company derives its revenues from IMAX theater systems (the sale and lease of, and provision of services related to, its theater systems to large-format theaters, including joint revenue sharing arrangements), films (production and digital re-mastering of films, the distribution of film products to the IMAX theater network, post-production services for large-format films), theater operations (owning, operating, managing or participating in the profits of IMAX theaters) and other activities, which include the sale of after market parts and camera rentals. Segmented information is provided in note 22 to the accompanying audited consolidated financial statements contained in Item 8.

IMAX Theater Systems

The Company's primary products are its large-format theater systems. IMAX theater systems traditionally include a unique rolling loop 15/70-format projector that offers superior image quality and stability and a digital theater control system; a 6-channel, digital sound system delivering up to 12,000 watts; a screen with a proprietary coating technology; and, if applicable, 3D glasses cleaning equipment. As part of the arrangement to sell or lease its theater systems, the Company provides extensive advice on theater planning and design and supervision of installation services. Theater systems are also leased or sold with a license for the use of the world famous IMAX brand. The Company primarily offers its theater systems in four configurations: the GT projection system for the largest IMAX theaters; the SR system for smaller theaters; the Company's newest introduction, the IMAX MPX system, which is targeted for multiplex complexes; and a fourth category of theater systems featuring heavily curved and tilted screens that are used in dome shaped theaters. The GT, SR and IMAX MPX systems are flat screens that have a minimum of curvature and tilt and can exhibit both 2D and 3D films, while the screen components in dome shaped theaters are generally 2D only and are popular with the Company's institutional clients. The Company is also currently developing a digital projector.

Screens in IMAX theaters are as large as one hundred or more feet wide and eight stories tall and the Company believes they are the largest cinema screens in the world. Unlike standard cinema screens, IMAX screens extend to the edge of a viewer's peripheral vision to create immersive experiences which, when combined with the Company's superior sound system components, make audiences feel as if they are a part of the on-screen action in a way that is more intense and exciting than in traditional theaters, a critical part of *The IMAX Experience*. The Company's IMAX 3D theaters further increase the audience's feeling of immersion in the film by bringing images off the screen. All IMAX theaters, with the exception of dome configurations, have a steeply inclined floor to provide each audience

member with a clear view of the screen. IMAX holds patents on the geometrical design of an IMAX theater.

The Company's projectors utilize the largest commercially available film format (15-perforation film frame, 70mm), which is nearly 10 times larger than conventional film (4-perforation film frame, 35mm) and therefore able to project significantly more detail on a larger screen. The Company believes its projectors, which utilize the Company's rolling loop technology, are unsurpassed in their ability to project film with maximum steadiness and clarity with minimal film wear while substantially enhancing the quality of the projected image. As a result, the Company's projectors deliver a higher level of clarity, detail and brightness compared to conventional movies and competing film or digitally-based projectors.

Table of Contents**IMAX CORPORATION****Item 1. Business** (cont d)**PRODUCT LINES** (cont d)**IMAX Theater Systems** (cont d)

To complement the film technology and viewing experience, IMAX provides unique digital sound system components. The sound system components are among the most advanced in the industry and help to heighten the sense of realism of a 15/70-format film. IMAX sound system components are specifically designed for IMAX theaters and are an important competitive advantage. The Company believes it is a world leader in the design and manufacture of digital sound system components for applications including traditional movie theaters, auditoriums and IMAX theaters.

Theater System Sales or Leases. The Company's arrangements for theater system equipment involve either a lease or sale. As part of the arrangement for an IMAX theater system, the Company also advises the customer on theater design, supervises the installation of the theater systems and provides projectionists with training in using the equipment. Theater owners or operators are responsible for providing the theater location, the design and construction of the theater building, the installation of the system components and any other necessary improvements, as well as the marketing and programming at the theater. The supervision of installation requires that the equipment also be put through a complete functional start-up and test procedure to ensure proper operation. The Company's typical arrangement also includes the trademark license rights which commence on execution of the agreement and generally have terms of 10 to 20 years that may be renewed. The theater system equipment components (including the projector, sound system, and screen system and if applicable, 3D glasses cleaning machine), theater design support, supervision of installation, projectionist training and trademark rights are all elements of what the Company considers the system deliverable (the System Deliverable). For a separate fee, the Company provides ongoing maintenance and extended warranty services for the theater system.

Leases generally have 10 to 20-year initial terms and are typically renewable by the customer for one or more additional 10-year term. Under the terms of the typical lease agreement, the title to the theater system equipment (including the projector, the sound system and the projection screen) remains with the Company. The Company has the right to remove the equipment for non-payment or other defaults by the customer. The contracts are generally not cancelable by the customer unless the Company fails to perform its obligations. The Company also enters into sale agreements with its customers. Under a sales arrangement, the title to the theater system remains with the customer, however in certain instances, the Company retains title or a security interest in the equipment until the customer has made all payments required under the agreement. Recently the Company has entered into a number of joint revenue sharing arrangements, where the Company receives a portion of a theater's box-office and concession revenue in exchange for placing a theater system at the theater operator's venue. Under these arrangements, the Company receives no up-front fee and the Company retains title to the theater system. The Company has stated that it will increasingly look to enter into such arrangements in the future, although the specific customer and location will be important considerations in whether to do so. The Company believes that its joint revenue sharing arrangements represent an effective way for it to deploy capital, add incremental theater growth and realize the benefits of network economics more quickly. The Company believes that by its contributing the theater system, with the exhibitor responsible for the theater retrofit costs, it significantly lowers the capital cost for exhibitors to deploy an IMAX theater, which, in turn, expands the IMAX network more rapidly and provides the Company with an increasingly significant portion of the IMAX box office from its licensed theaters, as well as a continuing portion of the IMAX DMR film revenue from the film studio. The Company's contracts are generally denominated in U.S. dollars, except in Canada, Japan and parts of Europe, where contracts are sometimes denominated in local currency.

The typical lease or sales arrangement provides for three major sources of cash flows for the Company: (i) initial fees; (ii) ongoing minimum fixed and contingent fees and (iii) ongoing maintenance and extended warranty fees. Initial fees generally are received over the period of time from the date the arrangement is executed to the date the equipment is installed and customer acceptance has been received. However, in certain cases the payments of the initial fee may be scheduled over a period after the equipment is installed and customer acceptance has been received. Ongoing minimum fixed and contingent fees and ongoing maintenance and extended warranty fees are generally

received over the life of the arrangement and are usually adjusted annually based on changes in the local consumer price index. The ongoing minimum fixed and contingent fees generally provide for a fee which is the greater of a fixed amount or a certain percentage of the theater box-office. The terms of each arrangement vary according to the configuration of the theater system provided and the geographic location of the customer.

Sales Backlog. Signed contracts for theater systems are listed as sales backlog prior to the time of revenue recognition. The value of sales backlog represents the total value of all signed theater system sales and sales-type lease agreements that are expected to be recognized as revenue in the future. Sales backlog includes initial fees along with the present value of contractual fixed minimum fees due over the term, but excludes contingent fees in excess of contractual minimums and maintenance and extended warranty fees that might be received in the future. Sales backlog does not include any anticipated revenues from theaters in which the Company has an equity-interest, joint profit or revenue sharing arrangements, agreements covered by letters of intent or conditional sale or lease commitments.

Table of Contents**IMAX CORPORATION****Item 1. Business** (cont d)**PRODUCT LINES** (cont d)**IMAX Theater Systems** (cont d)

The following chart shows the number of the Company's theater systems by configuration, opened theater network base and backlog as of December 31:

		2006				
		2D Theater Network		3D Theater Network		
	System	Base	Backlog	System	Base	Backlog
Flat Screen	IMAX	41		IMAX 3D GT	85	12
				IMAX 3D SR	51	11
				IMAX MPX	32	49
Dome Screen	IMAX Dome	69	2	IMAX 3D Dome	6	
Total					284	74

		2005				
		2D Theater Network		3D Theater Network		
	System	Base	Backlog	System	Base	Backlog
Flat Screen	IMAX	45		IMAX 3D GT	77	16
				IMAX 3D SR	48	13
				IMAX MPX	21	42
Dome Screen	IMAX Dome	68	2	IMAX 3D Dome	7	
Total					266	73

IMAX and IMAX Dome Systems. IMAX and IMAX Dome systems make up approximately 39% of the Company's opened theater base. IMAX theaters, with a flat screen, were introduced in 1970, while IMAX Dome theaters, which are designed for tilted dome screens, were introduced in 1973. There have been several significant proprietary and patented enhancements to these systems since their introduction.

IMAX 3D GT and IMAX 3D SR Systems. IMAX 3D theaters utilize a flat screen 3D system, which produces realistic three-dimensional images on an IMAX screen. The Company believes that the IMAX 3D theater systems offer consumers one of the most realistic 3D experiences available today. To create the 3D effect, the audience uses either polarized or electronic glasses that separate the left-eye and right-eye images. The IMAX 3D projectors can project both 2D and 3D films, allowing theater owners the flexibility to exhibit either type of film. The Company will provide upgrades to existing theaters which have 2D IMAX theater systems, to IMAX 3D theater systems. Since the introduction of IMAX 3D technology, the Company has upgraded 18 theaters.

In 1997, the Company launched a smaller IMAX 3D system called IMAX 3D SR, a patented theater system configuration that combines a proprietary theater design, a more automated projector and specialized sound system

components to replicate the experience of a larger IMAX 3D theater in a smaller space.

Table of Contents**IMAX CORPORATION****Item 1. Business** (cont d)**PRODUCT LINES** (cont d)**IMAX Theater Systems** (cont d)

IMAX MPX. In 2003, the Company launched its new large-format theater system designed specifically for use in multiplex theaters. Known as IMAX MPX, this system projects 15/70-format film onto screens which are curved and tilted forward to further immerse the audience. An IMAX MPX theater system utilizes the Company's next generation proprietary digital sound system components, capable of multi-channel uncompressed studio quality digital audio. The projector is capable of playing both 2D and 3D films, and installs into a standard 35mm projection booth. The IMAX MPX system can be installed as part of a newly-constructed multiplex, as an add-on to an existing multiplex or as a retrofit of one or two existing stadium seat auditoriums within a multiplex. With lower capital and operating costs, the IMAX MPX is designed to improve a multiplex owner's financial returns and allow for the installation of IMAX theater systems in markets that might previously not have been able to support one. The Company has signed 84 agreements for IMAX MPX theater systems since its introduction, nine of which were installed in 2006. Five of the 84 signed agreements were for conditional deals where the conditions have since lapsed.

IMAX Digital. The Company is in the process of developing a digitally-based IMAX projector designed to deliver 2D and 3D presentations with the high image quality and immersiveness that are consistent with the IMAX brand, without the need for analog prints. The Company holds numerous digital patents and relationships with key manufacturers and suppliers in digital technology. The Company has patents, applications and licenses encompassing, among other things, a method for synchronizing digital data, a method of generating stereoscopic (3D) imaging data from a 2D source, a process for digitally re-mastering 35mm films into 15/70-format, a method for increasing the dynamic range and contrast of projectors, a method for invisibly seaming or superimposing images from multiple projectors and other inventions relating to digital projectors. The Company anticipates that its digital projector, which will be targeted to a large portion of its commercial theater base, will be available for production and sale by early 2009. The Company's goal is to create a digital product that provides a differentiated experience to moviegoers that is consistent with what they have come to expect from the IMAX brand. The Company believes that transitioning from a film-based platform to a digital platform for a large portion of its customer base is compelling for a number of reasons. The savings to the studios as a result of eliminating film prints are considerable, as the typical cost of an IMAX film print ranges from \$22.5 thousand per 2D print to \$45 thousand per 3D print. Removing those costs will significantly increase the profit of an IMAX release for a studio which, the Company believes, provides more incentive for studios to release their films to IMAX theaters. The Company similarly believes that economics change favorably for its exhibition clients as a result of a digital transition, since lower print costs and the increased programming flexibility that digital delivery provides should allow theaters to program three to four additional IMAX DMR films per year, thereby increasing both customer choice and total box-office revenue. Finally, digital transmission allows for the opportunity to show attractive alternate programming, such as live events like the Super Bowl or World Cup, in the immersive environment of an IMAX theater.

Films***Film Production and Digital Re-mastering (IMAX DMR)***

Films produced by the Company are typically financed through third parties, whereby the Company will generally receive a film production fee in exchange for producing the film and will be a distributor of the film. The ownership rights to such films may be held by the film sponsors, the film investors and/or the Company. In the past, the Company often internally financed film production, but has moved to a model utilizing third-party funding for the large-format films it produces and distributes.

In 2002, the Company developed technology that makes it possible for 35mm live-action film to be digitally transformed into IMAX's 15/70-format at a cost of roughly \$1.0 - \$2.0 million per film. This proprietary system, known as IMAX DMR, has opened the IMAX theater network up to film releases from Hollywood's broad library of films. In a typical IMAX DMR film arrangement, the Company will absorb its costs for the IMAX DMR re-mastering and then recoup this cost from a percentage of the gross box-office receipts of the film, which will generally range from 10-15%. The Company may also have certain distribution rights to the 15/70-format films produced using its IMAX

DMR technology.

Table of Contents

IMAX CORPORATION

Item 1. Business (cont d)

PRODUCT LINES (cont d)

Films (cont d)

Film Production and Digital Re-Mastering (IMAX DMR) (cont d)

The IMAX DMR process involves the following:

scanning, at the highest resolution possible, each individual frame of the 35mm film and converting it into a digital image;

optimizing the image using proprietary image enhancement tools;

analyzing the information contained within a 35mm frame format and enhancing the digital image using techniques such as sharpening, color correction, grain removal and the elimination of unsteadiness and removal of unwanted artifacts; and

recording the enhanced digital image onto 15/70-format film.

The first IMAX DMR film, *Apollo 13: The IMAX Experience*, produced in conjunction with Universal Pictures and Imagine Entertainment, was released in September 2002. Since the release of that film, the Company has released an additional 17 IMAX DMR films.

The highly automated IMAX DMR system typically allows the re-mastering process to meet aggressive film production schedules. The Company is continuing to improve the length of time it takes to reformat a film with its IMAX DMR technology. *Apollo 13: The IMAX Experience*, released in 2002, was re-mastered in 16 weeks, while *300: The IMAX Experience*, released in March 2007, was re-mastered in approximately ten days. The IMAX DMR conversion of simultaneous, or day-and-date, releases are done in parallel with the movie's filming and editing, which is necessary for the simultaneous release of an IMAX DMR film with the domestic release to conventional theaters.

The Company demonstrated its ability to convert computer generated animation to IMAX 3D with the 1999 release of *Cyberworld*, the 2004 release of the full length CGI feature, *The Polar Express: The IMAX 3D Experience* and the release of three CGI 3D features in 2005-2006. In addition, the Company has developed a proprietary technology to convert live action 2D 35mm movies to IMAX 3D films, which the Company believes can offer significant potential benefits to the Company, studios and the IMAX theater network, and which was used to convert scenes from 2D to 3D in the film *Superman Returns: An IMAX 3D Experience* in 2006, and *Harry Potter and the Order of the Phoenix: An IMAX 3D Experience*, released in July 2007.

For IMAX DMR releases, the original soundtrack of the 35mm film is also re-mastered for IMAX's five or six-channel digital sound system components. Unlike conventional theater sound systems, IMAX sound system components are uncompressed, full fidelity and use proprietary loudspeaker systems and surround sound that ensure every theater seat is in a good listening position.

In 2006, the Company released seven films converted through the IMAX DMR process contemporaneously with the releases of the films to conventional 35mm theaters, and released one film, *Deep Sea 3D*, co-produced by the Company and made exclusively for IMAX theaters.

On March 3, 2006, IMAX and Warner Bros. Pictures (WB) released *Deep Sea 3D*. This was shortly followed by the release on March 17, 2006 of *V for Vendetta: The IMAX Experience* by the Company and WB. On May 12, 2006, the Company and WB released *Poseidon: The IMAX Experience*. On June 28, 2006, the Company and WB released *Superman Returns: An IMAX 3D Experience*, an IMAX DMR version of one of the year's top grossing Hollywood films, to the IMAX theater network. On July 28, 2006, the Company and WB released *The Ant Bully: An IMAX 3D Experience*. On September 29, 2006, the Company and Sony Pictures released *Open Season: An IMAX 3D Experience*. On November 17, 2006, the Company and WB released *Happy Feet: The IMAX Experience*. On December 22, 2006, the Company and Twentieth Century Fox released the IMAX DMR version of the hit film *Night at the Museum* to IMAX theaters.

The Company believes that these releases have positioned IMAX theaters as a separate distribution platform for Hollywood films, similar to the type created when Hollywood studios began including the pay TV and home video media as release windows for their films.

Table of Contents**IMAX CORPORATION****Item 1. Business** (cont d)**PRODUCT LINES** (cont d)**Films** (cont d)***Film Production and Digital Re-Mastering (IMAX DMR)*** (cont d)

In 2007, the Company has thus far released three IMAX DMR films to IMAX theaters contemporaneously with the releases of the films to conventional 35mm theaters. In March 2007, the Company and WB released *300: The IMAX Experience*. In May 2007, the Company and Sony's Columbia Pictures released *Spider-Man 3: The IMAX Experience*. In July 2007, the Company, in conjunction with WB, released *Harry Potter and the Order of the Phoenix: An IMAX 3D Experience*. This will be WB's fifth film release based on the popular Harry Potter book series. In November 2007, the Company in conjunction with Paramount Pictures, Shangri-La Entertainment and WB will release *Beowulf: An IMAX 3D Experience*. The Company has announced that it will release an IMAX DMR version of *The Dark Knight: The IMAX Experience*, the next installment of WB's highly-popular Batman franchise, in July 2008, and that, in conjunction with WB, it has commenced production on a third original IMAX 3D co-production for the release to IMAX theaters in 2009 of a sequel to *Deep Sea 3D*.

Film Distribution

The Company is a significant distributor of 15/70-format films. The Company generally distributes films which it has produced or for which it has acquired distribution rights from independent producers. As a distributor, the Company receives a fixed fee and/or a percentage of the theater box-office receipts.

The library of 15/70-format films includes Hollywood event films converted into 15/70-format through IMAX DMR technology, such as the 2006 (and 2007) hit *Night at the Museum: The IMAX Experience*, and the 2004 (and 2005) hit *The Polar Express: The IMAX 3D Experience*, along with general entertainment and educational films on subjects such as space, wildlife, music, history and natural wonders. The library consisted of 254 films at the end of 2006, of which the Company had distribution rights to 52 such films. 15/70-format films that have been successfully released by the Company include *Deep Sea 3D*, which was released by the Company and WB in March 2006 and has grossed more than \$29.5 million to the end of 2006, *SPACE STATION*, which was released in April 2002 and has grossed over \$93.2 million to the end of 2006, *T-REX: Back to the Cretaceous*, which was released by the Company in 1998 and has grossed over \$95.0 million to the end of 2006 and *Fantasia 2000: The IMAX Experience*, which was released by the Company and Buena Vista Pictures Distribution, a unit of The Walt Disney Company, in 2000, and has grossed over \$80.4 million to the end of 2006. 15/70-format films have significantly longer exhibition periods than conventional 35mm films and many of the films in the large-format library have remained popular for many decades including the films *To Fly!* (1976), *Grand Canyon - The Hidden Secrets* (1984) and *The Dream Is Alive* (1985).

Film Post-Production

David Keighley Productions 70MM Inc., a wholly-owned subsidiary of the Company, provides film post-production and quality control services for 15/70-format films (whether produced internally or externally), and digital post-production services.

Theater Operations

The Company has seven owned and operated theaters. In addition, the Company has entered into commercial arrangements with two theaters resulting in the sharing of profits and losses. The Company also provides management services to two theaters.

Other**Cameras**

The Company rents 2D and 3D 15/70-format analog cameras and provides technical and post-production services to third-party producers for a fee. The Company has developed state-of-the-art patented dual and single filmstrip 3D cameras which are among the most advanced motion picture cameras in the world and are the only 3D cameras of their kind. The IMAX 3D camera simultaneously shoots left-eye and right-eye images and its compact size allows filmmakers access to a variety of locations, such as underwater or aboard aircraft. The Company maintains cameras and other film equipment to support third-party producers and also offers production advice and technical assistance

to filmmakers.

Table of Contents**IMAX CORPORATION****Item 1. Business (cont d)****MARKETING AND CUSTOMERS**

The Company markets its theater systems through a direct sales force and marketing staff located in offices in Canada, the United States, Europe, and Asia. In addition, the Company has agreements with consultants, business brokers and real estate professionals to locate potential customers and theater sites for the Company on a commission basis.

The commercial theater segment of the Company's theater network is now its largest segment, with a total of 166 theaters opened as of December 31, 2006. The Company's institutional customers include science and natural history museums, zoos, aquaria and other educational and cultural centers. The Company also sells or leases its theater systems to theme parks, tourist destination sites, fairs and expositions. At December 31, 2006, approximately 37% of all opened IMAX theaters were in locations outside of North America. The following table outlines the breakdown of the theater network by geographic location as at December 31:

	2006 Theater Network Base	2005 Theater Network Base
United States	139	134
Canada	23	22
Mexico	16	13
Europe	48	47
Japan	13	14
Rest of World	45	36
Total	284	266

For information on revenue breakdown by geographic area, see note 22 to the accompanying audited consolidated financial statements in Item 8. No one customer represents more than 5% of the Company's opened base of theaters. The Company has no dependence upon a single customer, the loss of which would have a material adverse effect on the Company.

INDUSTRY AND COMPETITION

The Company competes with a number of manufacturers of large-format film projectors. Most of these competitors utilize smaller film formats, including 8-perforation film frame 70mm and 10-perforation film frame 70mm formats, which the Company believes deliver an image that is inferior to *The IMAX Experience*. The IMAX theater network and the number of 15/70-format films to which the Company has distribution rights are substantially larger than those of its 15/70-format competitors, and IMAX DMR reformatted films are available exclusively to the IMAX theater network. The Company's customers generally consider a number of criteria when selecting a large-format theater including quality, reputation, brand-name recognition, configuration of system components, features, price and service. The Company believes that its competitive strengths include the value of the IMAX brand name, the quality and historic up-time of IMAX theater systems, the return on investment of an IMAX theater, the number and quality of 15/70-format films that it distributes, the quality of the sound system components included with the IMAX theater, the availability of Hollywood event films to IMAX theaters through IMAX DMR technology and the level of the Company's service and maintenance and extended warranty efforts. Virtually all of the best performing large-format theaters in the world are IMAX theaters.

In 2003, the Company introduced the IMAX MPX, a new theater system designed specifically for use in multiplex auditoriums. The IMAX MPX system is designed to reduce the capital and operating costs required to run an IMAX theater while still offering consumers the image and sound quality of *The IMAX Experience*.

The motion picture industry is in the early stages of transitioning from film projection to digital projection, and the Company itself is developing a digitally-based projector. In recent years, a number of companies have introduced digital 3D projection technology and a small number of Hollywood features have been exhibited in 3D using these technologies. The Company believes that its many competitive strengths, including the IMAX® brand name, the quality and immersiveness of *The IMAX Experience*, its IMAX DMR technology and its patented theater geometry, significantly differentiate the Company's 3D presentations from any other 3D presentations.

Page 12

Table of Contents**IMAX CORPORATION****Item 1. Business (cont'd)****THE IMAX BRAND**

The IMAX brand is world famous and stands for immersive family entertainment that combines stunning images of exceptional quality and clarity on screens up to one hundred feet wide and eight stories tall with the Company's proprietary 6-channel digital sound system components and unique theater designs. The Company's research shows that the IMAX brand is a significant factor in a consumer's decision to go to an IMAX theater, and that movie-goers are willing to travel significantly farther and pay more to see films in IMAX's immersive format. In addition, the Company believes that its significant brand loyalty among consumers provides it with a strong, sustainable position in the exhibition industry. The IMAX brand name cuts across geographic and demographic boundaries.

Historically, the Company's brand identity was grounded in its educational film presentations to families around the world. With an increasing number of IMAX theaters based in multiplexes and with a recent history of commercially successful large-format films such as *The Polar Express: The IMAX 3D Experience*, *Harry Potter and The Goblet of Fire: The IMAX Experience*, *Batman Begins: The IMAX Experience*, *Superman Returns: An IMAX 3D Experience*, *Happy Feet: The IMAX Experience* and *Night at the Museum: The IMAX Experience*, the Company is rapidly increasing its presence in commercial settings. The Company believes the strength of the IMAX brand will be an asset as it continues to establish IMAX theaters as a new and desirable release window for Hollywood films.

RESEARCH AND DEVELOPMENT

The Company believes that it is one of the world's leading entertainment technology companies with significant in-house proprietary expertise in digital and film based projection and sound system component design, engineering and imaging technology, particularly in 3D. The Company believes that the motion picture industry will be affected by the development of digital technologies, particularly in the areas of content creation (image capture), post-production (editing and special effects), digital re-mastering (such as IMAX DMR), distribution and display. The Company has made significant investments in digital technologies, including the development of a proprietary, patent-pending technology to digitally enhance image resolution and quality of 35mm motion picture films, the conversion of monoscopic (2D) to stereoscopic (3D) images and the creation of an IMAX digital projector prototype, and holds a number of patents, patents pending and other intellectual property rights in these areas. In addition, the Company holds numerous digital patents and relationships with key manufacturers and suppliers in digital technology. The Company is in the process of developing a digitally-based projector which would operate without the need for analog film prints. The Company anticipates that its digital projector, which will be targeted to a large portion of its commercial theater customer base, will be available for production and sale by early 2009.

The IMAX DMR technology converts a conventional 35mm frame into its digital form at a very high resolution. The proprietary system recreates a pristine form of the original photography. The Company believes the proprietary process makes the images sharper than the original and the completed re-mastered film, now nearly 10 times larger than the original, is transferred onto the Company's 15/70 film format. Each film's original soundtrack is also recreated and upgraded to Company standards. Through its research and development program, the Company continues to refine and enhance the capabilities of this technology.

A key to the performance and reliability of the IMAX projector is the Company's unique rolling loop film movement. The rolling loop advances the film horizontally in a smooth, wave-like motion, which enhances the stability of the image and greatly reduces wear of the film.

Several of the underlying technologies and resulting products and system components of the Company are covered by patents or patent applications. Other underlying technologies are available to competitors, in part because of the expiration of certain patents owned by the Company. The Company, however, has successfully obtained patent protection covering several of its significant improvements made to such technologies. The Company plans to continue to fund research and development activity in areas considered important to the Company's continued commercial success.

For 2006, 2005 and 2004, the Company recorded research and development expenses of \$3.6 million, \$3.2 million and \$4.0 million, respectively.

As of December 31, 2006, 35 of the Company's employees were connected with research and development projects.

Table of Contents

IMAX CORPORATION

Item 1. Business (cont d)

MANUFACTURING AND SERVICE

Projector Component Manufacturing

The Company assembles the projector of its large-format theater systems at its Corporate Headquarters and Technology Center in Mississauga, Canada (near Toronto). A majority of the parts and sub-assemblies for this component are purchased from outside vendors. The Company develops and designs all the key elements for the proprietary technology involved in this component. Fabrication of parts and sub-assemblies is subcontracted to a group of carefully pre-qualified suppliers. Manufacture and supply contracts are signed for the delivery of the component on an order-by-order basis. The Company has developed long-term relationships with a number of significant suppliers, and the Company believes its existing suppliers will continue to supply quality products in quantities sufficient to satisfy its needs. The Company inspects all parts and sub-assemblies, completes the final assembly and then subjects the projector to comprehensive testing individually and as a system prior to shipment. In 2006, these projectors had operating availability based on scheduled shows of approximately 99.8%.

Sound System Component Manufacturing

The Company develops, designs and assembles the key elements of its theater sound system component. The standard IMAX theater sound system component comprises parts from a variety of sources with approximately 50% of the materials of each sound system attributable to proprietary parts provided under original equipment manufacturers agreements with outside vendors. These proprietary parts include custom loudspeaker enclosures and horns and specialized amplifiers, signal processing and control equipment. The Company inspects all parts and sub-assemblies, completes the final assembly and then subjects the sound system component to comprehensive testing individually and as a system prior to shipment.

Screen and Other Components

The Company purchases its screen component and glasses cleaning equipment from third parties. The standard screen system component is comprised of a projection screen treated with a proprietary coating and a frame to hang the projection screen. The glasses cleaning machine is a stand-alone unit that is connected to the theater's water and electrical supply to automate the cleaning of 3D glasses.

Maintenance and Extended Warranty Services

The Company also provides ongoing maintenance and extended warranty services to IMAX theater systems. These arrangements are usually for a separate fee; however, the Company often includes free service in the initial year of an arrangement. The maintenance and extended warranty arrangements include service, maintenance and replacement parts for theater systems.

To support the IMAX theater network, the Company has personnel stationed in major markets who provide periodic and emergency maintenance and extended warranty services on existing theater systems throughout the world. The Company provides various levels of maintenance and warranty services which are priced accordingly. Under full service programs, Company personnel typically visit each theater every three months to provide preventative maintenance, cleaning and inspection services and emergency visits to resolve problems and issues with the theater system. Under some arrangements, customers can elect to participate in a service partnership program whereby the Company trains a customer's technician to carry out certain aspects of maintenance. Under such shared maintenance arrangements, the Company participates in certain of the customer's maintenance checks each year, provides for a specified number of emergency visits and provides spare parts as necessary.

PATENTS AND TRADEMARKS

The Company's inventions cover various aspects of its proprietary technology and many of these inventions are protected by Letters of Patent or applications filed throughout the world, most significantly in the United States, Canada, Belgium, Japan, France, Germany and the United Kingdom. The subject matter covered by these patents, applications and other licenses encompasses theater design and geometry, electronic circuitry and mechanisms employed in film projectors and projection equipment (including 3D projection equipment), a method for synchronizing digital data, a method of generating stereoscopic (3D) imaging data from a 2D source, a process for digitally re-mastering 35mm films into 15/70-format, a method for increasing the dynamic range and contrast of

projectors, a method for visibly seaming or superimposing images from multiple projectors and other inventions relating to digital projectors. The Company has been diligent in the protection of its proprietary interests.

Table of Contents

IMAX CORPORATION

Item 1. Business (cont d)

PATENTS AND TRADEMARKS (cont d)

The Company currently holds or licenses 46 patents, has 7 patents pending in the United States and has corresponding patents or filed applications in many countries throughout the world. While the Company considers its patents to be important to the overall conduct of its business, it does not consider any particular patent essential to its operations. Certain of the Company's patents in the United States, Canada and Japan for improvements to the IMAX projection system components expire between 2009 and 2024.

The Company owns or otherwise has rights to trademarks and trade names used in conjunction with the sale of its products, systems and services. The following trademarks are considered significant in terms of the current and contemplated operations of the Company: IMAX[®], *The IMAX Experience*[®], *An IMAX Experience*[®], IMAX DMR[®], IMAX[®] 3D, IMAX[®] Dome, IMAX MPX[®], IMAX think big[®] and think big[®]. These trademarks are widely protected by registration or common law throughout the world. The Company also owns the service mark IMAX THEATRE .

EMPLOYEES

As of December 31, 2006, the Company had 345 employees, not including hourly employees at Company owned and operated theaters.

AVAILABLE INFORMATION

The Company makes available free of charge its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K as soon as reasonably practicable after such filings have been made with the United States Securities and Exchange Commission (the SEC). Reports may be obtained through the Company's website at www.imax.com or by calling the Company's Investor Relations Department at 212-821-0100.

Item 1A. Risk Factors

If any of the risks described below occurs, the Company's business, operating results and financial condition could be materially adversely affected.

The risks described below are not the only ones the Company faces. Additional risks not presently known to the Company or that it deems immaterial, may also impair its business or operations.

Amended disclosure contained in this section supercedes similar disclosure elsewhere in this Form 10-K/A that has not been amended.

RISKS RELATED TO THE COMPANY'S RECENT RESTATEMENTS AND RELATED MATTERS

The Company is subject to ongoing informal inquiries by regulatory authorities in the U.S. and Canada and it cannot predict the timing of developments and outcomes in these matters.

The Company is the subject of informal inquiries by the SEC and the Ontario Securities Commission (the OSC); these inquiries focus on the Company's accounting policies and related matters. The Company cannot predict when these inquiries will be completed, the further timing of any other developments in connection with the inquiries, or the results or outcomes of these inquiries.

Expenses incurred in connection with these informal inquiries (which include substantial fees of lawyers and other professional advisors) and potential obligations to indemnify officers and directors who could, at a future date, be parties to such actions, continue to adversely affect the Company's cash position and profitability.

The informal inquiries may adversely affect the Company's ability to obtain, and/or increase the cost of obtaining, directors and officers' liability insurance, which could have a material adverse effect on the Company's business, results of operations and financial condition. It may also adversely affect the course of the pending litigation against the Company. The Company is currently defending a consolidated class-action lawsuit in the U.S. and a class-action lawsuit in Ontario (see Item 3. Legal Proceedings). Negative developments or outcomes in the informal inquiries could have an adverse effect on the Company's defense of lawsuits. Finally, the SEC and/or OSC could impose sanctions and/or fines on the Company in connection with the aforementioned inquiries. The indenture dated as of December 4, 2003, and as thereafter amended and supplemented, (the Indenture) governing the Company's 9.625% Senior Notes due 2010 (the Senior Notes) contains a covenant requiring the timely filing of its financial statements with regulatory agencies. Additional changes to the Company's accounting policies and/or additional restatements could result in the failure of the Company to meet these deadlines and cause the holders of its Senior Notes to

accelerate payment. In addition, these informal investigations could divert attention of the Company's management and other personnel for significant periods of time.

Table of Contents

IMAX CORPORATION

Item 1A. Risk Factors (cont d)

RISKS RELATED TO THE COMPANY'S RECENT RESTATEMENTS AND RELATED MATTERS (cont d)
Resolution of the Company's unresolved SEC and OSC staff comments and informal SEC and OSC enforcement division inquiries may result in additional changes in accounting.

In 2006 and 2007, the staff of the SEC and OSC sent comment letters to the Company raising questions as to the Company's revenue recognition policies and other areas, including the Company's recognition of theater system components at different points in time. The comments also raised questions regarding the Company's accounting for settlement income, receivable provisions and certain transactions with Digital Projection International. In addition, the Company was asked to enhance its disclosures in its Annual Report on Form 10-K, particularly in the area of revenue recognition policies. As noted in notes 2(n) and 4 to the accompanying audited consolidated financial statements in Item 8, the Company revised its revenue recognition policy for theater systems and recently restated its financial statements for the current and prior periods to reflect the correction of errors related to revenue recognition, real estate leases and other errors. The Company is continuing to discuss these issues with the SEC and OSC. It is possible that such discussions could result in a further restatement of the Company's financial statements and amendments to this report or prior Annual Reports and Quarterly Reports, filed on Form 10-K and Form 10-Q, respectively.

The Company is subject to lawsuits that could divert its resources and result in the payment of significant damages and other remedies.

The Company's industry is characterized by frequent claims and related litigation regarding breach of contract and related issues. The Company is subject to a number of legal proceedings and claims that arise in the ordinary course of its business. In addition, the Company is engaged as a defendant in several class action lawsuits filed by certain shareholders of the Company and one action filed by a bondholder of the Company. Since March 2007, this bondholder has repeatedly and unsuccessfully attempted to trigger a default or acceleration under the indenture governing the Company's Senior Notes. The Company cannot assure that it will succeed in defending any claims, that judgments will not be entered against it with respect to any litigation or that reserves the Company may set aside will be adequate to cover any such judgments. If any of these actions or proceedings against the Company is successful, it may be subject to significant damages awards. In addition, the Company is the plaintiff in a number of lawsuits in which it seeks the recovery of substantial payments. The Company is incurring significant legal fees in prosecuting and defending its lawsuits, and it may not ultimately prevail in such lawsuits or be able to collect on such judgments if it does.

Although the Company's directors and officers liability insurance is deemed to provide coverage for the class-action lawsuits the Company is defending (see Item 3. Legal Proceedings), the damages in such lawsuits could be significant. Additionally, the defense of these claims (as with the defense or prosecution of all of the Company's litigation) could divert the attention of the Company's management and other personnel for significant periods of time.

The Company has been the subject of anti-trust complaints and investigations in the past and may be sued or investigated on similar grounds in the future.

Table of Contents

IMAX CORPORATION

Item 1A. Risk Factors (cont d)

RISKS RELATED TO THE COMPANY S RECENT RESTATEMENTS AND RELATED MATTERS (cont d)

The Company has identified a number of material weaknesses related to its internal controls over financial reporting. These material weaknesses could continue to impact the Company s ability to report its financial results accurately and in a timely manner.

Taxation of Other Stock Based Awards

Other awards may be granted under the Plan. Since the amount, character and timing of income recognized in connection with such awards will vary depending upon the specific terms and conditions of such awards, no information regarding the tax consequences of the receipt of such awards may be provided at this time.

The Board recommends that you vote FOR the approval of the Directors Plan. Proxies solicited by the Board will be voted FOR the approval of the Directors Plan unless instructions to the contrary are given.

Table of Contents

PROPOSAL NO. 4

RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS

The Audit Committee has appointed Ernst & Young LLP, a registered independent accounting firm, as the Company's independent auditors to audit its consolidated financial statements for the year ending December 31, 2004, subject to ratification of the appointment by the Company's stockholders. During the 2003 fiscal year, Ernst & Young LLP served as the Company's independent auditors and also provided certain tax and audit-related services. The Company has been advised by Ernst & Young LLP that neither it nor any of its members has any direct or indirect financial interest in the Company.

Although the Company is not required to seek stockholder approval of this appointment, the Audit Committee and the Board believe it to be sound corporate practice to do so. If the appointment is not ratified, the Audit Committee will investigate the reasons for stockholder rejection and the Audit Committee will reconsider the appointment. Representatives of Ernst & Young LLP are expected to attend the Annual Meeting where they will be available to respond to appropriate questions and, if they desire, to make a statement.

The Audit Committee recommends a vote FOR the ratification of the appointment of Ernst & Young LLP as the company's independent auditors. Proxies solicited by the Board will be voted FOR the ratification of the appointment of Ernst & Young LLP as the Company's independent auditors unless instructions to the contrary are given.

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following tables set forth information, as of August 26, 2004, concerning:

beneficial ownership of the Company's common stock by SZ Investments, LLC, Third Avenue Management L.L.C. and D. E. Shaw Laminar Portfolios, L.L.C., which are the only beneficial owners of 5% or more of the Company's common stock;

beneficial ownership of the Company's common stock by (i) all of the Company's current directors and nominees for election as directors, (ii) those executive officers named in the Summary Compensation Table included in this proxy statement and (iii) all of the current directors and executive officers of the Company together as a group.

The number of shares beneficially owned by each entity, person, current director or named executive officer is determined under the rules of the SEC, and the information is not necessarily indicative of beneficial ownership for any other purpose. Under such rules, beneficial ownership includes any shares as to which the individual has the right to acquire within 60 days after the date of this table, through the exercise of any stock option or other right. Unless otherwise indicated, each person has sole investment and voting power, or shares such powers with his or her spouse, or dependent children within his or her household with respect to the shares set forth in the following table. Unless otherwise indicated, the address for all current executive officers and directors is c/o Danielson Holding Corporation, 2 North Riverside Plaza, Suite 600, Chicago, Illinois 60606

Common Stock Ownership of Certain Beneficial Owners

Name and Address	Number of Shares Beneficially Owned ⁽¹⁾	Approximate Percent of Class
SZ Investments LLC ⁽²⁾ Two North Riverside Plaza Chicago, Illinois 60606	11,796,442	16.20%
Third Avenue Management LLC ⁽³⁾ 622 Third Avenue, 32nd floor New York, New York 10017	4,535,622(4)	6.23%
D. E. Shaw Laminar Portfolios, L.L.C. ⁽⁵⁾ 120 West Forth Fifth Street, Floor 39, Tower 45 New York, New York 10036	13,629,222	18.72%

- (1) In accordance with provisions of the Company's certificate of incorporation, all certificates representing shares of common stock beneficially owned by holders of five percent or more of the common stock are owned of record by the Company, as escrow agent, and are physically held by the Company in that capacity.
- (2) Samuel Zell, Chairman of the Board, was our President and Chief Executive Officer from July, 2002 until his resignation as of April 27, 2004 and has been a director since 1999. Philip Tinkler has been our Chief Financial Officer since January, 2003. William Pate has been a director since 1999. Each of Messrs. Zell, Tinkler and Pate is an executive officer of EGI and SZ Investments LLC.
- (3) Third Avenue Management LLC (Third Avenue), a registered investment advisor under Section 203 of the Investment Advisors Act of 1940, as amended, invests funds on a discretionary basis on behalf of investment companies registered under the Investment Company Act of 1940, as amended, and on behalf of individually managed separate accounts. Martin J. Whitman and David M. Barse, who are members of our Board, serve as officers of Third Avenue. Mr. Whitman also serves as an officer and a trustee of Third Avenue Trust and Mr. Barse serves as an officer and a trustee of Third Avenue Trust. Mr. Whitman was Chairman of our Board and Chief Executive Officer from July, 1996 until July, 2002. Mr. Barse was our President and Chief Operating Officer from July, 1996 until July, 2002.
- (4) The shares beneficially owned by Third Avenue are held by Third Avenue Value Fund Series of the Third Avenue Trust. These shares do not include the following shares held by each of Messrs. Whitman and

Table of Contents

Barse: (i) 1,254,145 shares beneficially owned by Mr. Whitman (including 166,426 shares owned by Mr. Whitman's wife and 318,496 shares beneficially owned by a private investment company of which Mr. Whitman is the principal shareholder), and (ii) 486,932 shares beneficially owned by Mr. Barse (including shares underlying currently exercisable options to purchase an aggregate of 138,425 shares of common stock).

- (5) Does not include the number of shares of common stock which D. E. Shaw Laminar Portfolios, L.L.C. will have the right to purchase in a rights offering of up to 3,000,000 shares of our common stock at a purchase price of \$1.53 per share which the Company is required to conduct in order to satisfy its obligations as the sponsor of the plan of reorganization of Covanta. The rights offer will be made solely to holders of the \$100,000,000 of principal amount of 9.25% Debentures due 2002 issued by Covanta that voted in favor of Covanta's second reorganization plan on January 12, 2004. On January 12, 2004, holders of \$99,600,000 in principal amount of 9.25% Debentures voted in favor of the plan of reorganization and are eligible to participate in the rights offering. As of January 12, 2004, D. E. Shaw Laminar held approximately \$10.4 million of the 9.25% Debentures and would be entitled to purchase up to approximately 313,253 shares of common stock. The Company intends to file a registration statement with the Securities and Exchange Commission with respect to such rights offering and the statements contained herein shall not constitute an offer to sell or the solicitation of an offer to buy shares of the Company's common stock. Any such offer or solicitation will be made in compliance with all applicable securities laws.

Equity Ownership of Management

Name and Address	Number of Shares Beneficially Owned ⁽¹⁾	Approximate Percent of Class
Samuel Zell	11,938,684(2)	16.37%
David M. Barse	5,022,554(3)	6.88%
Ronald J. Broglio	0	*
Peter C.B. Bynoe	0	*
Michael C. Hagan (President and Chief Executive Officer of ACL May 29, 2002-October 31, 2003)	52,671	*
Richard L. Huber	75,597(4)	*
Eugene M. Isenberg	317,379(5)	*
William Pate	161,642	*
Jean Smith	0	*
Joseph P. Sullivan	86,665(6)	*
Philip G. Tinkler	25,604	*
Martin J. Whitman	5,789,767(7)	7.95%
Clayton C. Yeutter	36,665(8)	*
All Officers and Directors as a group (13 persons)	23,454,557	32.05%(9)

* Percentage of shares beneficially owned does not exceed one percent of the outstanding common stock.

- (1) In accordance with provisions of the Company's certificate of incorporation, all certificates representing shares of common stock beneficially owned by holders of five percent or more of the common stock are owned of record by the Company, as escrow agent, and are physically held by the Company in that capacity.
- (2) Includes 11,796,442 shares of common stock owned by SZ Investments, LLC, which is indirectly owned by trusts established for the benefit of Mr. Zell and members of his family. Also includes shares underlying currently exercisable options to purchase 129,166 shares of common stock at an exercise price of \$3.37 per share owned by EGI, also indirectly owned by trusts established for the benefit of Mr. Zell

Table of Contents

and members of his family and 13,076 shares owned by the Helen Zell Revocable Trust, as to which Mr. Zell disclaims beneficial ownership except to the extent of his pecuniary interest therein.

- (3) Includes 4,535,622 shares beneficially owned by Third Avenue, which is affiliated with Mr. Barse. Mr. Barse disclaims beneficial ownership of these shares. Also includes shares underlying currently exercisable options to purchase 50,000 shares of common stock at an exercise price of \$5.69, shares underlying currently exercisable options to purchase 50,000 shares of common stock at an exercise price of \$7.06 and shares underlying currently exercisable options to purchase 38,425 shares of common stock at an exercise price of \$5.31.
- (4) Includes 12,453 shares of vested restricted stock and 12,453 unvested shares of restricted stock issued to Mr. Huber. Also includes shares underlying currently exercisable options to purchase 13,333 shares of common stock at an exercise price of \$4.26.
- (5) Includes 284,776 shares owned by Salmon Atlas, a partnership controlled by Mr. Isenberg and his wife.
- (6) Includes shares underlying currently exercisable options to purchase 50,000 shares of common stock at an exercise price of \$5.78 and shares underlying currently exercisable options to purchase 13,333 shares of common stock at an exercise price of \$4.26.
- (7) Includes 4,535,622 shares of common stock beneficially owned by Third Avenue, which is affiliated with Mr. Whitman. Also includes 318,496 shares of common stock beneficially owned a private investment company of which Mr. Whitman is the principal shareholder and 166,426 shares of common stock beneficially owned by Mr. Whitman's wife.
- (8) Includes shares underlying currently exercisable options to purchase 13,333 shares of common stock at an exercise price of \$4.26.
- (9) Includes shares underlying currently exercisable options to purchase 357,590 shares of common stock that our directors and executive officers have the right to acquire within 60 days of the date of this table.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors and executive officers, and persons who own more than ten percent of a registered class of the Company's equity securities, to file with the SEC and the American Stock Exchange initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Executive officers, directors and greater than ten-percent stockholders are required by Federal securities regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based upon a review of filings with the SEC and/or written representations from certain reporting persons, the Company believes that all of its directors, executive officers and other Section 16 reporting persons complied during fiscal 2003 with the reporting requirements of Section 16(a) except that Mr. Zell filed late one Form 4 with respect to shares held by his spouse as trustee of a revocable trust.

Table of Contents**EXECUTIVE COMPENSATION**

The following table sets forth information concerning the annual and long-term compensation for services in all capacities to the Company, or its subsidiary companies or their predecessors for 2001 through 2003 of those persons who served as (i) the Chief Executive Officer during 2003, (ii) the most highly compensated executive officer employed by the Company as of December 31, 2003, and (iii) the former Chief Executive Officer and director of ACL, formerly a significant subsidiary of the Company, but who was not serving as an executive officer on December 31, 2003 (collectively, the Named Executive Officers):

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation ⁽⁴⁾		Other Annual Compensation ⁽²⁾	Long-Term Compensation		All Other Compensation ⁽⁴⁾
		Salary	Bonus ⁽¹⁾		Awards		
					Restricted Stock Awards ⁽³⁾	Securities Underlying Options	
Samuel Zell ⁽⁵⁾ President and Chief Executive Officer (July 24, 2002 - April 27, 2004)	2003	\$ 200,000					
	2002	\$ 87,949					
Michael C. Hagan ⁽⁶⁾ President and Chief Executive Officer ACL, formerly a significant subsidiary of the Company (May 29, 2002 to October 31, 2003)	2003	\$ 262,500		\$ 7,700			\$ 292,920
	2002	\$ 315,000	N/A	\$ 9,240	\$ 556,205	\$ 210,000	\$ 52,007
Philip G. Tinkler Chief Financial Officer (January 22, 2003 - Present)	2003	\$ 68,750					

(1) No bonuses were paid to Named Executive Officers in 2003.

(2) Consists of automobile allowance only.

(3) Consists of the dollar value of restricted stock awards (calculated by multiplying the number of shares awarded by the closing market price of the Company's common stock on the date of the grant which was \$6.16 as of the May 29, 2002 grant date) to certain members of ACL management made in restricted Company common stock as part of the Company's recapitalization whereby Mr. Hagan, who held preferred membership units in American Commercial Holdings LLC (ACL Holdings) at the time of the Company's recapitalization abandoned those units to ACL Holdings for no consideration and received 90,293 shares of restricted Company common stock for his continued employment with ACL, 60,195 of such shares were forfeited upon Mr. Hagan's termination of employment.

(4) Amounts shown include the 2002 above-market portion of earnings on a CSX Corporation deferred compensation program available to Mr. Hagan through his employment at ACL in the amount of \$29,621. Amounts shown also include life insurance premium payments made on behalf of Mr. Hagan in the amount of \$5,433; matching contributions made by ACL in conjunction with deferral of salary or bonus to a supplementary savings plan on behalf of Mr. Hagan in the amount of \$9,450; and payment for the provision of tax services for Mr. Hagan in the amount of \$1,991. Amounts for 2002 also include matching contributions made by ACL to Mr. Hagan to the ACL 401(k) plan in the amount of \$5,512.

For 2003, includes severance pay of \$275,000; life insurance premium payment made on behalf of Mr. Hagan in the amount of \$2,901; payment for the provision of tax services for Mr. Hagan in the amount of \$2,903; and accrued vacation pay of \$12,116.

Edgar Filing: IMAX CORP - Form 10-K/A

- (5) Mr. Zell resigned as President and Chief Executive Officer of the Company on April 27, 2004 and Jeffrey R. Horowitz was appointed, effective April 27, 2004, to serve as President and Chief Executive Officer of the Company on an interim basis.
- (6) Amounts shown for Mr. Hagan were paid by ACL, formerly a significant subsidiary of the Company as of December 27, 2002 and until January 31, 2003.

Table of Contents**Option/ SAR Grants**

There were no stock options or stock appreciation rights granted to the Company's Named Executive Officers in 2003.

The following table sets forth the number of securities underlying unexercised options held by each of the Named Executive Officers and the value of such options at the end of fiscal 2003:

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year End Option Values

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year End Exercisable/Unexercisable	Value of Unexercised In-the-Money Options at Fiscal Year End Exercisable/Unexercisable ⁽¹⁾
Samuel Zell	N/A	N/A	0/0	\$ 0/0
Michael C. Hagan	N/A	N/A	26,250/0	\$ 0/0
Philip G. Tinkler	N/A	N/A	4,166/834	\$ 0/0

- (1) Value of unexercised options at fiscal year-end represents the difference between the exercise price of any outstanding in-the-money options and \$2.95, the mean value of the Company's common stock on December 31, 2003. All outstanding options have exercise prices in excess of \$2.95 and, as a result, none of the options have value as of December 31, 2003.

Equity Compensation Plan Information

The following table sets forth information regarding the number of securities which could be issued upon the exercise of outstanding options, the weighted average exercise price of those options and the number of securities remaining for future issuance under the 1995 Plan as of December 31, 2003. The Company does not have any equity compensation plans that have not been approved by its security holders.

Plan Category	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A) ⁽¹⁾
	(A)	(B)	(C)
Equity Compensation Plans Approved by Security Holders	2,564,543	\$ 4.79	2,141,048
Equity Compensation Plans Not Approved by Security Holders	N/A	N/A	N/A
TOTAL	2,564,543	\$ 4.79	2,141,048(1)

- (1) Assuming approval of the Employees Plan and the Directors Plan by the stockholders at the Annual Meeting, the Company intends to terminate the 1995 Plan and consequently, any future grants of options would be made under the Employees Plan or the Directors Plan, as applicable.

Employment Arrangements

In connection with his retirement on October 31, 2003, a separation agreement between Michael C. Hagan and ACL was approved by the bankruptcy court administering ACL's bankruptcy petition. Under this agreement, Mr. Hagan agreed, among other things, that he would (i) not compete with or solicit employees or customers from ACL during the period from the date of his retirement through June 30, 2004, and (ii) release ACL from all claims he may have against ACL, including any claims relating to his employment with and his separation from ACL, arising under any employment benefit program of ACL, relating to any severance or similar benefit program of ACL, and arising under any age

discrimination laws. Under this separation agreement, Mr. Hagan also provided certain consulting services to ACL through June 30, 2004, including,

Table of Contents

advising ACL on asset dispositions, its bankruptcy proceedings, and certain customer and business transitional matters. In exchange for his agreements under the separation agreement, including his agreement not to compete with ACL and his release of claims, Mr. Hagan received \$275,000 in addition to a \$25,000 per month payment for his consulting services performed thereunder. Mr. Hagan participates in ACL's group medical and dental insurance plans for two years after his separation and maintains his participation under ACL's pension plan and 401(k) plan.

Also in connection with his retirement from ACL, Mr. Hagan agreed with the Company to extend the period during which Mr. Hagan can exercise options to acquire 26,250 shares of the Company's common stock to the one-year period running from his retirement date through October 31, 2004. Under this agreement, the Company and Mr. Hagan mutually agreed to waive and release the other from all claims that may have existed between them, other than any arising under the Company's or any of its subsidiaries' indemnification obligations to its current and former directors, members, officers or board of representative members.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

SZ Investments, LLC (SZI), a company affiliated with Sam Zell, our Chairman of the Board, William Pate, a member of our Board and Philip Tinkler, our Chief Financial Officer, is a holder through its affiliate, HY I Investments, L.L.C. (HYI), of approximately 42% of the senior notes and payment-in-kind notes of ACL, an unconsolidated subsidiary of the Company. In addition, the Company has agreed to provide SZI unlimited demand registration rights with respect to the ACL notes held by HYI. ACL is currently subject to Chapter 11 bankruptcy proceedings. As a result, a special committee of our board of directors was formed in November 2002, composed solely of disinterested directors, to oversee our investment in ACL and its related Chapter 11 bankruptcy proceedings.

We have entered into a corporate services agreement dated as of September 2, 2003, pursuant to which Equity Group Investments, L.L.C., referred to in this proxy statement as EGI, has agreed to provide certain administrative services to us, including, among others, shareholder relations, insurance procurement and management, payroll services, cash management, tax and treasury functions, technology services, listing exchange compliance and financial and corporate record keeping. Samuel Zell, Chairman of our Board, is also the Chairman of EGI, and Philip Tinkler, our Chief Financial Officer and William Pate, a member of our Board, are also executive officers of EGI. Under the agreement, we pay to EGI \$20,000 per month plus specified out-of-pocket fees and expenses incurred by EGI under this corporate services agreement. Either party may terminate this corporate services agreement on 30 days written notice. The Company and EGI intend to terminate this agreement with the integration of Covanta's operations with the Company's prior to December 31, 2004.

We also had entered into a non-exclusive investment advisory agreement dated April 14, 1999 with EGI pursuant to which EGI had agreed to provide upon our request, investment banking services in connection with potential transactions. In addition, in the event that a transaction was consummated for which our board of directors determined that EGI provided material services, EGI would be entitled to a fee from us in the amount of 1% of the aggregate consideration in connection with such transaction, including indebtedness assumed or outstanding. As a result of services provided to us during our recapitalization in 2002, we agreed with EGI that a fee of \$3.0 million was payable to EGI. We also agreed to reimburse, upon request, EGI's out-of-pocket expenses related to services provided under the investment advisory agreement. We did not pay any fees for services in 2003 to EGI. On December 1, 2003 we terminated this agreement with EGI. In addition, for providing a standby commitment to purchase any of our shares that were unsubscribed in a prior rights offering conducted by us as part of our acquisition of ACL, we paid SZI a fee of \$1.0 million.

As part of the investment and purchase agreement dated as of December 2, 2003 pursuant to which the Company agreed to acquire Covanta, the Company arranged for a new replacement letter of credit facility for Covanta, secured by a second priority lien on Covanta's available domestic assets, consisting of commitments for the issuance of standby letters of credit in the aggregate amount of \$118 million. This financing was provided by SZI, Third Avenue Trust, on behalf of Third Avenue Value Fund Series (Third Avenue) and D. E. Shaw Laminar Portfolios, L.L.C., a significant creditor of Covanta (Laminar) and together with SZI

Table of Contents

and Third Avenue, the Bridge Lenders). Each of SZI, Third Avenue and Laminar or an affiliate own over 5% of the Company s common stock. Samuel Zell, Chairman of the Board, Philip G. Tinkler, Chief Financial Officer of the Company and William Pate, a director of the Company, are affiliated with SZI. Martin Whitman and David Barse, directors of the Company, are affiliated with Third Avenue. This second lien credit facility has a term of five years. The letter of credit component of the second lien credit facility requires cash collateral to be posted for issued letters of credit in the event Covanta has cash in excess of specified amounts. Covanta also paid an upfront fee of \$2.36 million upon entering into the second lien credit agreement, and will pay (1) a commitment fee equal to 0.5% per annum of the daily calculation of available credit, (2) an annual agency fee of \$30,000, and (3) with respect to each issued letter of credit an amount equal to 6.5% per annum of the daily amount available to be drawn under such letter of credit. Amounts paid with respect to drawn letters of credit bear interest at the rate of 4.5% over the base rate on issued letters of credit, increasing to 6.5% over the base rate in specified default situations. Subsequent to the signing of the investment and purchase agreement, each of the Bridge Lenders assigned approximately 30% of their participation in the second lien letter of credit facility to Goldman Sachs Credit Partners, L.P. and Laminar assigned the remainder of its participation in the second lien letter of credit facility to TRS Elara, LLC.

The Company obtained the financing for its acquisition of Covanta pursuant to a note purchase agreement dated December 2, 2003, from the Bridge Lenders. Pursuant to the note purchase agreement, the Bridge Lenders provided the Company with \$40 million of bridge financing in exchange for notes issued by the Company. The Company repaid the notes with the proceeds from a rights offering of common stock of the Company which was completed in June 2004 and in connection with the conversion of a portion of the note held by Laminar into 8.75 million shares of common stock of the Company pursuant to the note purchase agreement. In consideration for the \$40 million of bridge financing and the arrangement by the Bridge Lenders of the \$118 million second lien credit facility and the arrangement by Laminar of a \$10 million international revolving credit facility secured by Covanta s international assets, the Company issued to the Bridge Lenders an aggregate of 5,120,853 shares of common stock.

In connection with the note purchase agreement, the Company agreed with the Bridge Lenders to file a registration statement with the SEC to register the shares of common stock issued to them under the note purchase agreement. The Company registered such shares of common stock with the SEC under a registration statement which was declared effective on August 24, 2004.

As part of the Company s negotiations with Laminar and their becoming a 5% shareholder, pursuant to a letter agreement dated December 2, 2003, Laminar has agreed to transfer restrictions on the shares of common stock that Laminar acquired pursuant to the note purchase agreement. Further, in accordance with the transfer restrictions contained in Article Five of the Company s charter restricting the resale of the Company s common stock by 5% stockholders, the Company has agreed with Laminar to provide it with limited rights to resell the common stock that it holds.

Also in connection with the financing for the acquisition of Covanta, we have agreed to pay up to \$0.9 million in the aggregate to the Bridge Lenders as reimbursement for expenses incurred by them in connection with the note purchase agreement.

The arrangements described above are each on terms and conditions that we believe are in the aggregate not materially more burdensome to us than would be obtained on an arm s-length basis among unaffiliated parties.

Clayton Yeutter, a director of the Company, is of counsel to the law firm of Hogan & Hartson LLP. Hogan & Hartson provided Covanta with certain legal services during 2003 and continues to do so in the current fiscal year. Mr. Yeutter does not directly or indirectly benefit from those fees and the Board has determined that such relationship does not interfere with Mr. Yeutter s exercise of independent judgment as a director.

Table of Contents

**BOARD OF DIRECTORS COMPENSATION COMMITTEE REPORT
ON EXECUTIVE COMPENSATION**

The Compensation Committee of the Board of Directors (the Committee) during 2003 was comprised of three independent directors under applicable American Stock Exchange listing standards. The Committee provided the following report on executive compensation during 2003 as required by applicable securities regulations and the Committee's charter:

The Committee's overriding goal continues to be to structure compensation in a way that will attract and retain highly qualified executives who will conduct the business of the Company in a manner that will maximize stockholder value.

Upon becoming Chief Executive Officer of the Company in 2002, Mr. Zell's annual base salary was established at \$200,000. This is the same as the annual base salary that was previously paid to Mr. Whitman, the prior Chief Executive Officer of the Company.

In 2003, the Company tried to balance its desire not to take significant additional cash out of the Company in the form of executive compensation while searching for opportunities to meet its goal of maximizing stockholder values with the reality of the extensive efforts which each of these executives undertakes in overseeing the Company's operations as well as identifying and negotiating potential opportunities on behalf of the Company. The Company was able to retain Mr. Zell at his level of base compensation in part because Mr. Zell is employed by affiliates of the Company. The Committee continues to believe that it was appropriate to maintain these compensation levels for its executive officers. The Committee will continue to review bonus compensation in light of the Company's achievements in any given year and the role the executives play in those achievements.

In addition to the cash compensation of its executives, the Company granted stock options during the year under its 1995 Stock and Incentive Plan (the 1995 Plan).

In making determinations regarding compensation for its chief executive officer in particular, and its other executive officers, in general, the Committee does not rely upon quantitative measures or other measurable objective indicia, such as earnings or specifically weighted factors or compensation formulae. In light of the fact that the Company, at the parent-company level, is a holding company with a small staff responsible for numerous and diverse areas of the Company's business and management, and given the high level of awareness each executive has of the others' activities and contributions, the Committee evaluates executive performance and reaches compensation decisions based, in part, upon the recommendations of the Company's executives.

Finally, the Committee notes that Section 162(m) of the Internal Revenue Code, in most circumstances, limits to \$1 million the deductibility of compensation, including stock-based compensation, paid to top executives by public companies. None of the 2003 compensation paid to the executive officers named in the Summary Compensation Table exceeded the threshold for deductibility under Section 162(m).

The Danielson Holding Corporation Compensation Committee:

Joseph P. Sullivan, Chairman
Peter C.B. Bynoe (as of July 19, 2004)
Eugene Isenberg
Clayton Yeutter

Compensation Committee Interlocks and Insider Participation

During 2003, David Barse, Joseph P. Sullivan, Eugene Isenberg and Clayton Yeutter were members of the Compensation Committee. Mr. Barse resigned from the Compensation Committee on March 5, 2004. None of the persons who served as members of the Compensation Committee in 2003 was, during that year or

Table of Contents

previously, an officer or employee of the Company or any of its subsidiaries or had any other relationship requiring disclosure herein, except as follows:

David Barse, is the Chief Executive Officer of Third Avenue Trust and Third Avenue, the sole investment advisor to the Third Avenue Value Fund Series of Third Avenue Trust. Third Avenue is the beneficial owner of over 5% of the common stock of the Company. Mr. Barse served also as the President and Chief Operating Officer of the Company from July 1996 until July 24, 2002. Please see Certain Relationships and Related Party Transactions above for a description of Third Avenue's transactions with the Company in connection with the note purchase agreement dated December 2, 2003 and Third Avenue's participation as a Bridge Lender pursuant thereto.

Clayton Yeutter is of counsel to the law firm of Hogan & Hartson LLP, which provided Covanta with certain legal services during 2003 and continues to do so in the current year. Mr. Yeutter does not directly or indirectly benefit from those fees and the Board has determined that such relationship does not interfere with Mr. Yeutter's exercise of independent judgment as a director.

Pension Plans

In 2003, the Company did not offer a pension benefit. National American Insurance Company of California (NAICC) and Covanta each offer certain pension and retirement benefits.

Benefit Plans

In 2003, the Company did not offer employee benefits. However, Mr. Hagan participated in the ACL 401(k) plan and received health benefits through ACL. NAICC and Covanta each offer certain benefit plans.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee of the Company's Board is responsible for providing independent, objective oversight of the Company's accounting functions and internal controls. The Audit Committee is composed of four directors. Each of the current directors is independent as defined by the American Stock Exchange listing standards. The Audit Committee operates under a written charter and key practices approved by the Board. A copy of the charter and key practices are attached hereto as Appendix A.

Management is responsible for the Company's internal controls and financial reporting process. Ernst & Young LLP (Ernst & Young), a registered independent public accounting firm and the Company's independent auditors for 2003, are responsible for performing an independent audit of the Company's consolidated financial statements in accordance with generally accepted auditing standards and to issue a report thereon. The Audit Committee's responsibility is to monitor and oversee these processes.

In connection with these responsibilities, the Audit Committee met with management and Ernst & Young to review and discuss the December 31 2003 financial statements. The Audit Committee also discussed with Ernst & Young the matters required by Statement on Auditing Standards No. 61 (Communication with Audit Committees). The Audit Committee also received written disclosure from Ernst & Young required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and the Audit Committee discussed with Ernst & Young the firm's independence.

Table of Contents

Based upon the Audit Committee's discussions with management and Ernst & Young, and the Audit Committee's review of the representations of management and Ernst & Young, the Audit Committee recommended that the Board include the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

The Danielson Holding Corporation Audit Committee

Richard L. Huber, Chairman

Jean Smith (as of March 5, 2004)

Joseph P. Sullivan

Clayton Yeutter

INDEPENDENT AUDITORS FEES

The following table shows the fees that the Company paid for audit, audit-related, and tax services rendered by Ernst & Young for the years ended December 31, 2003 and December 27, 2002:

Services	2003	2002
Audit Fees	\$ 844,790	\$ 1,106,942
Audit-Related Fees	\$ 292,395	\$ 79,805
Tax Fees	\$ 407,199	\$ 124,860
All Other Fees	\$	\$
	<hr/>	<hr/>
Total	\$ 1,544,384	\$ 1,311,607
	<hr/>	<hr/>

Audit Fees. This category includes the audit of the Company's annual financial statements, review of financial statements included in the Company's Quarterly Reports on Form 10-Q or services that are normally provided by Ernst & Young in connection with statutory and regulatory filings or engagements for those fiscal years. This category also includes services normally provided by Ernst & Young in connection with statutory and regulatory filings or engagement for each of the referenced years. Fees also include statutory and financial audits for subsidiaries of the Company.

Audit-Related Fees. This category consists of assurance and related services provided by Ernst & Young that are reasonably related to the performance of an audit or review of the Company's financial statements and are not reported above under Audit Fees. These services were primarily related to financial statement audits of ACL's and NAICC's employee benefit plans in both 2003 and 2002, as well as accounting consultations in connection with the Covanta acquisition and ACL bankruptcy considerations in 2003.

Tax Fees. This category consists of professional services rendered by Ernst & Young for tax compliance, tax advice and tax planning. The services for fees under this category in 2003 were related principally to tax compliance services for U.S. federal and state and foreign tax returns, as well as tax consulting services for subsidiaries. The services for fees under this category in 2002 were for tax compliance and consulting services.

All Other Fees. This category consists of any other products or services provided by Ernst & Young not described above. Ernst & Young did not bill any fees that would be categorized as all other fees during either of the years ended December 31, 2003 and December 27, 2002.

Audit Committee's Pre-Approval Policies and Procedures

In March 2004, the Board, upon the recommendation of the Audit Committee, adopted an amended and restated Audit Committee Charter and Audit Committee Key Practices, which require the Audit Committee to pre-approve all permitted non-audit services. It is the Audit Committee's practice to restrict the non-audit services that may be provided to the Company by the Company's independent auditors primarily to tax services and merger and acquisition due diligence and integration services, and then only when the services offered by the auditor's firm are more effective or economical than services available from other providers, and, to the extent possible, only after competitive bidding for such services.

Table of Contents

In pre-approving the services generating fees in 2003, the Audit Committee has not relied on the de minimis exception to the SEC pre-approval requirements applicable to audit-related, tax and all other permitted non-audit services.

Change in Independent Accounting Firm

Danielson

During 2002, KPMG LLP (KPMG) served as the Company s principal independent accounting firm until July 25, 2002. On July 25, 2002, KPMG s appointment as the Company s principal independent accounting firm was terminated and Ernst & Young was engaged as the Company s principal independent accounting firm. The decision to change accounting firms was made by the Audit Committee of the Board. Prior to such change, the Company actively considered whether it was advisable to change firms following the Company s acquisition of ACL, whose business was different from the Company s traditional areas. The Company solicited bids from a group of accounting firms, including KPMG, and on the basis of that information the Audit Committee determined that the Company should change accounting firms.

In connection with the audits of the two fiscal years ended December 31, 2001 and December 31, 2000, and during the subsequent interim period through July 25, 2002, there were no disagreements with KPMG on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to their satisfaction would have caused them to make reference to the subject matter of the disagreement in connection with their reports.

KPMG did not audit the Company s consolidated financial statements and its subsidiaries for the year ended December 31, 2002. The audit reports of KPMG on the consolidated financial statements of the Company and its subsidiaries for the years ended December 31, 2001 and December 31, 2000, did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles.

During the Company s fiscal years ended December 31, 2001 and December 31, 2000 and the subsequent interim period through July 25, 2002, the Company did not consult with Ernst & Young regarding any of the matters or events set forth in Items 304(a)(2)(i) and (ii) of Regulation S-K.

Ernst & Young has reviewed the disclosures contained in this Proxy Statement under the heading Change in Independent Accounting Firm Danielson and concurs with the statements regarding Ernst & Young set forth herein. The Company has also provided KPMG with a copy of the disclosures contained herein. KPMG previously has furnished a letter to the SEC attached as Exhibit 16.1 to the Company s Current Report on Form 8-K filed on August 1, 2002.

Covanta

During 2003 and 2002, Deloitte & Touche LLP (Deloitte & Touche) served as Covanta s principal independent accounting firm. On March 30, 2004, following the Company s acquisition of Covanta, the Board of Directors of Covanta, upon recommendation of the Company s Audit Committee, which committee also serves as Covanta s Audit Committee, dismissed Covanta s independent auditors, Deloitte & Touche, and engaged the services of Ernst & Young, the Company s current independent auditors, as Covanta s new independent auditors.

During the two most recent fiscal years of Covanta ended December 31, 2003 and 2002 and the subsequent interim period through March 30, 2004, there were no disagreements between Covanta and Deloitte & Touche on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure which disagreements, if not resolved to Deloitte & Touche s satisfaction, would have caused it to make reference to the subject matter of the disagreement in connection with its reports.

None of the reportable events described under Item 304(a)(1)(v) of Regulation S-K occurred within the two most recent fiscal years of Covanta ended December 31, 2003 and 2002 or the subsequent interim period through March 30, 2004.

Table of Contents

The audit reports of Deloitte & Touche on the consolidated financial statements of Covanta for the fiscal years ended December 31, 2003 and 2002 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles, except that such reports included explanatory paragraphs with respect to Covanta's adoption of Statements of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations, No. 142, Goodwill and Other Intangible Assets, No. 144, Accounting for Impairment or Disposal of Long-Lived Assets and No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, and the uncertainty of Covanta continuing as a going concern and that such financial statements did not reflect or provide for the consequences of Covanta's bankruptcy proceedings.

During the two most recent fiscal years ended December 31, 2003 and 2002, and through March 30, 2004 (the date Ernst & Young was appointed), Covanta did not consult with Ernst & Young regarding any of the matters or events set forth in Item 304(a)(2)(i) and (ii) of Regulation S-K.

Ernst & Young has reviewed the disclosures contained in this Proxy Statement under the heading Change in Independent Accounting Firm Covanta and concurs with the statements regarding Ernst & Young set forth herein. The Company has also provided Deloitte & Touche with a copy of the disclosures contained herein. Deloitte & Touche previously has furnished a letter to the SEC attached as Exhibit 16.1 to the Company's Current Report on Form 8-K/A filed on April 1, 2004.

Table of Contents

PERFORMANCE GRAPH

The following graph sets forth a comparison of the yearly percentage change in the Company's cumulative total stockholder return on common stock with the Standard & Poor's 500 Stock Index* and the NASDAQ Financial Sub Index.** The foregoing cumulative total returns are computed assuming (i) an initial investment of \$100, and (ii) the reinvestment of dividends at the frequency with which dividends were paid during the applicable years. The Company has never paid any dividends on shares of common stock. The graph below reflects comparative information for the five fiscal years of the Company beginning with the close of trading on December 31, 1998 and ending December 31, 2003. The stockholder return reflected below is not necessarily indicative of future performance.

* The Standard & Poor's 500 Stock Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

** The NASDAQ Financial Sub Index (NFSI) is maintained by NASDAQ. As described by NASDAQ, the NFSI consists of 100 large financial organizations listed on the NASDAQ National Market.

INCORPORATION BY REFERENCE

The Report of the Compensation Committee of the Board on Executive Compensation, the Audit Committee Report (including reference to the independence of the members of the Audit Committee) and the Stock Price Performance Graph above are not deemed to be filed with the SEC and shall not be deemed incorporated by reference into any prior or future filings made by the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates such information by reference.

Table of Contents

PROPOSALS AND NOMINATIONS BY STOCKHOLDERS

In order for a proposal of a stockholder to be included in the proxy statement and form(s) of proxy relating to the Company's 2005 annual meeting, the proposal must be received by the Company no later than May 10, 2005. In order to be considered for stockholder action at the Company's 2005 annual meeting, a proposal of a stockholder must be received by the Company at its principal executive offices no later than July 24, 2005. All stockholder proposals should be directed to the attention of the Secretary of the Company at the address of the principal offices of the company as set forth on the first page of this proxy statement.

Timely receipt of a stockholder's proposal will satisfy only one of various conditions established by the SEC for inclusion in the Company's proxy materials.

ANNUAL REPORT

The Annual Report of the Company on Form 10-K for the year ended December 31, 2003 has been previously mailed to all stockholders of record.

By Order of the Board of Directors

DANIELSON HOLDING CORPORATION

DAVID S. STONE

Secretary

Dated: September 7, 2004

Table of Contents

APPENDIX A

DANIELSON HOLDING CORPORATION

**AUDIT COMMITTEE CHARTER
(As of March 5, 2004)**

The Audit Committee of the Board of Directors of Danielson Holding Corporation shall consist of a minimum of three Directors. Members of the Audit Committee shall be appointed annually by the Board of Directors upon the recommendation of the Nominating Committee and may be removed or replaced by the Board of Directors in its discretion. All members of the Audit Committee shall meet the independence requirements for Audit Committee members under the rules of the American Stock Exchange (AMEX) and applicable SEC rules and regulations. All members shall have sufficient financial experience and ability to enable them to discharge their responsibilities and at least one member shall be financially sophisticated as required under AMEX rules.

The purpose of the Audit Committee shall be to assist the Board of Directors in its oversight of the integrity of the financial statements and accounting processes of the Corporation, of the Corporation's compliance with legal and regulatory requirements, of the independence and qualifications of the independent auditor, and of the performance of the Corporation's internal audit function and independent auditors.

In furtherance of this purpose, the Audit Committee shall have the following authority and responsibilities:

1. To discuss with management and the independent auditor the annual audited financial statements and quarterly financial statements, including matters required to be reviewed under applicable legal, regulatory or AMEX requirements.
2. To discuss with management and the independent auditor, as appropriate, earnings press releases and financial information and earnings guidance provided to analysts and to rating agencies.
3. To recommend, for shareholder approval, the independent auditor to examine the Corporation's accounts, controls and financial statements. The Audit Committee shall have the sole authority and responsibility to select, evaluate and if necessary replace the independent auditor. The Audit Committee shall have the sole authority to approve all audit engagement fees and terms and the Audit Committee, or a member of the Audit Committee, must pre-approve any non-audit service provided to the Corporation by the Corporation's independent auditor.
4. To discuss with management and the independent auditor, as appropriate, any audit problems or difficulties and management's response, and the Corporation's risk assessment and risk management policies, including the Corporation's major financial risk exposure and steps taken by management to monitor and mitigate such exposure.
5. To review the Corporation's financial reporting and accounting standards and principles, significant changes in such standards or principles or in their application and the key accounting decisions affecting the Corporation's financial statements, including alternatives to, and the rationale for, the decisions made.
6. To review and approve the internal corporate audit staff functions and internal audit and financial control procedures.
7. To review, with the Corporation's chief financial officer or such others as the Audit Committee deems appropriate the Corporation's internal system of audit and financial controls and the results of internal audits.
8. To obtain and review at least annually a formal written report from the independent auditor delineating: the auditing firm's internal quality-control procedures; any material issues raised within the preceding five years by the auditing firm's internal quality-control reviews, by peer reviews of the firm, or by any governmental or other inquiry or investigation relating to any audit conducted by the firm. The

Table of Contents

Audit Committee will also review steps taken by the auditing firm to address any findings in any of the foregoing reviews.

9. To annually obtain, in order to assess auditor independence, a written statement from the Corporation's independent auditor that delineates all relationships between the independent auditor and the Corporation, and to review such written statement and present its findings to the Board of Directors.

10. To prepare and publish an annual Audit Committee report in the Corporation's proxy statement and SEC periodic reports.

11. To set policies for the hiring of employees or former employees of the Corporation's independent auditor.

12. To review and investigate any matters pertaining to the integrity of management, including conflicts of interest, or adherence to standards of business conduct as required in the policies of the Corporation. This should include regular reviews of the compliance processes in general and the corporate ombudsman process in particular. In connection with these reviews, the Audit Committee will meet, as deemed appropriate, with the general counsel and other Corporation officers or employees.

The Audit Committee shall meet separately at least quarterly with management and with the Corporation's independent auditors.

The Audit Committee shall have authority to retain such outside counsel, experts and other advisors as the Audit Committee may deem appropriate in its sole discretion. The Audit Committee shall have sole authority to approve and receive funding for related fees and retention terms.

The Audit Committee shall establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, as well as for confidential, anonymous submissions by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

The Audit Committee shall report its recommendations to the Board of Directors after each Audit Committee meeting and shall conduct and present to the Board of Directors an annual performance evaluation of the Audit Committee. The Audit Committee shall review at least annually the adequacy of this Charter and internal control procedures and recommend any proposed changes to the Board of Directors for approval.

The Audit Committee may adopt such additional procedures, consistent with this Charter, as the Audit Committee deems appropriate.

This Audit Committee Charter will be made available on the Corporation's website at www.danielsonholding.com.

Table of Contents

DANIELSON HOLDING CORPORATION

**AUDIT COMMITTEE KEY PRACTICES
(As of March 5, 2004)**

The Audit Committee has adopted the following key practices to assist it in undertaking the functions and responsibilities set forth in its charter:

1. *Meetings.* The Audit Committee will meet at least 4 times a year, generally on a day different than the regularly scheduled Board of Directors meeting to allow time for in-depth discussion.
2. *Review of Financial Statements.* The Audit Committee will review the Corporation's 10-K in detail with the CEO, the CFO and the full Board of Directors. The Audit Committee will meet to review the Corporation's 10-Q's with the CFO. The Audit Committee will prepare any report required to be included in public filings by an audit committee pursuant to SEC rules or American Stock Exchange requirements.
3. *Quarterly Review of CEO and CFO Certification Process.* In conjunction with its reviews of the 10-K's and 10-Q's, the Audit Committee will also review the process for the CEO and CFO quarterly certifications required by the SEC with respect to the financial statements and the Corporation's disclosure and internal controls, including any material changes or deficiencies in such controls.
4. *Review of Earnings Releases and Information Provided to Analysts and Rating Agencies.* The CFO shall review earnings releases with the Chairman of the Audit Committee prior to their release to the public. Prior to the event, the CEO or the CFO shall review with the Audit Committee, or the full Board of Directors, the substance of any presentations to analysts or rating agencies which constitute a shift in Corporation strategy or outlook. In addition, the CEO or CFO shall review subsequently with the Audit Committee, or the full Board of Directors, a summary of major presentations that have been given to analysts or rating agencies that do not constitute a shift in strategy or outlook.
5. *Approval of Audit and Non-audit Services.* In addition to approving the engagement of the independent auditor to audit the Corporation's consolidated financial statements, the Audit Committee will approve all use of the Corporation's independent auditor for non-audit services prior to any such engagement. To minimize relationships which could appear to impair the objectivity of the independent auditor, it is the Audit Committee's practice to restrict the non-audit services that may be provided to the Corporation by the Corporation's independent auditor primarily to tax services and merger and acquisition due diligence and integration services. The Corporation will obtain such limited non-audit services from the Corporation's auditor as permitted by American Stock Exchange rules and SEC rules and regulations and only when the services offered by the auditor's firm are more effective or economical than services available from other providers, and, to the extent possible, only following competitive bidding for such services.
6. *Hiring Guidelines for Independent Auditor Employees.* The Audit Committee has adopted the following practices regarding the hiring by the Corporation of any new partner, director, manager, staff, advising member of the department of professional practice, reviewing actuary, reviewing tax professional and any other persons having responsibility for providing audit assurance to the Corporation's independent auditor on any aspect of their certification of the Corporation's financial statements. Audit assurance includes all work that results in the expression of an opinion on financial statements, including audits of statutory accounts.
 - (a) No member of the audit team that is auditing the Corporation or a Corporation business can be hired into either entity or into a position to which that business reports for a period of 2 years following association with that audit.
 - (b) No former employee of the independent auditor may sign the Corporation's or an affiliate's SEC filing for 5 years following employment with the independent auditor.
 - (c) No former employee of the independent auditor may be named a Corporation or major affiliate officer for 3 years following employment by the independent auditor.

Table of Contents

(d) The Corporation's CFO must approve all executive-level and higher hires from the independent auditor.

(e) The Corporation's CFO shall report annually to the Audit Committee the profile of the preceding year's hires from the independent auditor.

7. Process for Handling Complaints About Accounting Matters. As part of the Board of Directors' procedure for receiving and handling complaints or concerns about the Corporation's conduct, the Audit Committee has established the following procedures for: (i) the receipt, retention, and treatment of complaints received by the Corporation regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by Corporation employees of concerns regarding questionable accounting or auditing matters.

(a) To facilitate the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing standards, the Corporation may engage a consultant for security matters to establish (i) a post office box to which such complaints may be addressed. Such post office box shall not be used for any other purpose, and/or (ii) a toll-free confidential telephone hot-line for employees to call.

(b) Immediately upon management's receipt of complaints regarding accounting, internal accounting controls or auditing matters, shall forward a copy thereof (or if received orally, a memorandum describing such communication) to the Corporation's general counsel, who shall maintain a copy of all such communications in his or her records for a period of three years.

(c) Upon receipt of such complaints, the general counsel shall immediately forward a copy of the complaint to the Chairman of the Audit Committee and as soon thereafter as practical, management's response to the communication.

(d) The Chairman of the Audit Committee may take such further action as he or she deems necessary to obtain further information in regard to such complaint from the person making the complaint, from management or from the Corporation's independent auditors as he or she deems appropriate.

(e) Unless the Chairman of the Audit Committee determines that such complaint is without merit, he or she will refer such complaint to the Audit Committee at its next scheduled meeting, or sooner if he or she determines a special meeting for consideration of the complaint is appropriate.

(f) The Audit Committee shall review the complaint and in such review may discuss the complaint with management and the independent auditors and take such actions as it deems necessary, which may include: (i) determining that such complaint is without merit, (ii) asking the complainant, management or the independent auditors for additional information, (iii) responding to the complaint, (iv) directing management or the independent auditors to make changes to the Corporation's financial statements or accounting or auditing procedures, and (v) taking such other actions as they deem necessary or appropriate.

(g) The availability of the post office box and its address, as well as the telephone number of the confidential hot-line, will be published in the Corporation's Code of Business Conduct and Ethics.

(h) Access to such post office box shall only be by such consultant for securities matters, if any, and the Corporation's general counsel.

(i) Anything received in such post office box shall not be opened by such consultant and shall promptly be forwarded to the Chairman of the Audit Committee.

(j) The Chairman of the Audit Committee shall inform management of the substance of such employee communication in a manner which will not reveal the identity of the employee. Thereafter, the communication will be processed as described in the paragraphs above.

Table of Contents

(k) In effecting these procedures, the Audit Committee may obtain advice from the Corporation's legal counsel or from counsel retained by the Audit Committee.

8. *Audit Committee Memberships.* The Audit Committee has determined that in view of the increasing demands and responsibilities of the Audit Committee, members of the Audit Committee should not serve on more than two additional Audit Committees of other public companies, and the Chairman of the Audit Committee should not serve on more than two other audit committees of a public company, unless the Board of Directors determines that such simultaneous service would not impair the relevant individual's ability to effectively serve on the Audit Committee. Existing relationships exceeding these limits may continue in place provided that the full Board of Directors determines that such relationships do not impair the member's ability to serve effectively on the Audit Committee.

9. *Code of Ethics for CEO and Senior Financial Officers.* Corporation's Audit Committee shall annually acknowledge that they shall abide by the Corporation's Code of Business Conduct and Ethics then in place, and to resolve ethically any actual or apparent conflicts of interest, and to comply with all generally accepted accounting principles, laws and regulations designed to produce full, fair accurate, timely and understandable disclosure in the Corporation's periodic reports filed with the SEC.

10. *Conflict of Interest Review.* The Audit Committee will review at least once a year the independence of the Corporation's auditors as defined by the rules, regulations and standards of the SEC and the American Stock Exchange.

11. *Related Party Transactions.* The Audit Committee shall be responsible for reviewing and approving all related party transactions involving the Corporation and the Corporation's subsidiaries.

12. *General Power to Investigate.* The Audit Committee shall investigate any matter brought to its attention, within the scope of its duties, with the power to retain expert advice and legal counsel for this purpose if, in its judgment, that is appropriate.

13. *Audit Partner Rotation.* The Audit Committee shall ensure that the lead audit partners assigned by the Corporation's independent auditor to the Corporation, and to each of its subsidiaries that have securities registered with the SEC, as well as the audit partner responsible for reviewing the Corporation's audit shall be changed at least every five years.

14. *Share Owner Ratification of Independent Auditor.* Although the Audit Committee has the sole authority to appoint, direct and monitor the independent auditor, the Audit Committee will continue its longstanding practice of recommending that the Board of Directors ask the shareholders, at their annual meeting, to approve the Audit Committee's selection of the independent auditor.

15. *Reports and Procedures.* The Audit Committee shall keep a written record of its proceedings. In advance of every regular meeting, the Chairman of the Audit Committee, with the assistance of the Secretary of the Corporation, shall prepare and distribute to the Audit Committee members and others as deemed appropriate by the Chairman, an agenda of matters to be addressed at the meeting. The Audit Committee may require officers and employees of the Corporation to produce such information and reports, including reports to be provided annually or on other regular bases, as the Audit Committee may deem appropriate. The Chairman of the Audit Committee shall report to the Board of Directors at each meeting of the Board of Directors on the Audit Committee's activities since the last Board of Directors meeting.

16. *Disclosure of Corporate Governance Key Practices.* These Key Practices will be made available on the Corporation's website at www.danielsonholding.com.

Table of Contents

APPENDIX B

**DANIELSON HOLDING CORPORATION
EQUITY AWARD PLAN FOR EMPLOYEES AND OFFICERS**

Table of Contents**TABLE OF CONTENTS**

	Page
SECTION 1. Purpose; Definitions	B-1
(a) Administrator	B-1
(b) Affiliate	B-1
(c) Applicable Laws	B-1
(d) Award	B-1
(e) Award Agreement	B-1
(f) Board	B-1
(g) Cause	B-1
(h) Code	B-1
(i) Committee	B-1
(j) Common Stock	B-1
(k) Company	B-1
(l) Director	B-1
(m) Disability	B-1
(n) Effective Date	B-1
(o) Employee	B-2
(p) Exchange Act	B-2
(q) Fair Market Value	B-2
(r) Incentive Stock Option	B-2
(s) Mature Shares	B-2
(t) Non-Qualified Stock Option	B-2
(u) Officer	B-2
(v) Option	B-2
(w) Participant	B-2
(x) Performance Award	B-2
(y) Plan	B-2
(z) Recipient	B-2
(aa) Restricted Stock	B-2
(bb) Retirement	B-2
(cc) Service Provider	B-3
(dd) Stock Appreciation Right	B-3
(ee) Share	B-3
(ff) Subsidiary	B-3
SECTION 2. Stock Subject to the Plan	B-3
SECTION 3. Administration of the Plan	B-3
(a) Administration	B-3
(b) Powers of the Committee	B-3
SECTION 4. Eligibility for Awards	B-4
SECTION 5. Limitations on Options	B-4
SECTION 6. Term of Plan	B-4
SECTION 7. Term of Option	B-4

Table of Contents

	<u>Page</u>
SECTION 8. Option Exercise Price and Consideration	B-5
(a) Exercise Price	B-5
(b) Waiting Period and Exercise Dates	B-5
(c) Form of Consideration	B-5
SECTION 9. Exercise of Option	B-5
(a) Procedure for Exercise; Rights as a Stockholder	B-5
(b) Termination of Relationship as Employee or Officer	B-6
(c) Disability of Recipient	B-6
(d) Death of Recipient	B-7
(e) Retirement of Recipient	B-7
(f) Cash out Provisions	B-8
SECTION 10. Restricted Stock	B-8
(a) Awards of Restricted Stock	B-8
(b) Awards and Certificates	B-8
(c) Terms and Conditions	B-8
(d) Other Provisions	B-9
SECTION 11. Deferral of Stock Award	B-9
SECTION 12. Other Awards	B-10
(a) Stock Appreciation Right	B-10
(b) Performance Award	B-10
(c) Other Stock-Based Awards	B-10
SECTION 13. Non-Transferability of Awards	B-10
SECTION 14. Adjustments Upon Changes in Capitalization	B-11
SECTION 15. Date of Grant	B-11
SECTION 16. Term; Amendment and Termination of the Plan	B-11
(a) Amendment and Termination	B-11
(b) Stockholder Approval	B-11
(c) Effect of Amendment or Termination	B-11
SECTION 17. Conditions Upon Issuance of Shares	B-11
(a) Legal Compliance	B-11
(b) Withholding Obligations	B-12
(c) Inability to Obtain Authority	B-12
(d) Grants Exceeding Allotted Shares	B-12
SECTION 18. General Provisions	B-12
(a) Term of Plan	B-12
(b) No Contract of Employment	B-12
(c) Severability	B-12
(d) Governing Law	B-12
(e) Dividends	B-12
(f) Prohibition on Loans to Participants	B-12
(g) Performance-Based Compensation	B-12
(h) Unfunded Status of Plan	B-13
(i) Liability of Committee Members	B-13

Table of Contents

**DANIELSON HOLDING CORPORATION EQUITY AWARD PLAN FOR
EMPLOYEES AND OFFICERS**

SECTION 1. *Purpose; Definitions.*

The purposes of this Plan are to promote the interests of the Company (including any Subsidiaries and Affiliates) and its stockholders by using equity interests in the Company to attract, retain and motivate its management and other eligible persons and to encourage and reward their contributions to the Company's performance and profitability.

The following capitalized terms shall have the following respective meanings when used in this Plan:

- (a) *Administrator* means the Board or any one of its Committees as shall be administering the Plan, in accordance with Section 3 of the Plan.
- (b) *Affiliate* means any corporation or other entity controlled by the Company and designated by the Committee as such.
- (c) *Applicable Laws* means the legal requirements relating to the administration of plans providing one or more of the types of Awards described in the Plan and the issuance of Shares thereunder pursuant to U.S. state corporate laws, U.S. federal and state securities laws, the Code and the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.
- (d) *Award* means a grant of an Option, Restricted Stock, stock appreciation right or other stock-based Award under the Plan, all on a stand alone, combination or tandem basis, as described in or granted under the Plan.
- (e) *Award Agreement* means a written agreement between the Company and a Participant evidencing the terms and conditions of an individual Award. The Award Agreement is subject to the terms and conditions of the Plan.
- (f) *Board* means the Board of Directors of the Company.
- (g) *Cause* shall mean, unless otherwise determined by the Committee, (i) the conviction of the Recipient for committing, or entering a plea of *nolo contendere* by the Recipient with respect to, a felony under federal or state law or a crime involving moral turpitude; (ii) the commission of an act of personal dishonesty or fraud involving personal profit in connection with the Recipient's employment by the Company; (iii) the willful misconduct, gross negligence or deliberate failure on the part of the Recipient to perform his or her employment duties with the Company in any material respect; or (iv) the failure to comply with Company policies or agreements with the Company, in any material respect.
- (h) *Code* means the Internal Revenue Code of 1986, as amended or replaced from time to time.
- (i) *Committee* means the Compensation Committee of the Board, or another committee appointed by the Board to administer the Plan, in accordance with Section 3 of the Plan.
- (j) *Common Stock* means the common stock, par value \$.10, of the Company.
- (k) *Company* means Danielson Holding Corporation, a Delaware corporation.
- (l) *Director* means a director serving on the Board of the Company who is not also an employee of the Company or any Subsidiary or Affiliate thereof; who has not been an employee of the Company during the taxable year or an officer of the Company at any time; and who has been duly elected to the Board by the stockholders of the Company or by the Board under applicable corporate law. Neither service as a Director nor payment of a director's fee by the Company shall, without more, constitute employment by the Company.
- (m) *Disability* means permanent and total disability as determined under procedures established by the Committee for the purposes of the Plan.

(n) *Effective Date* means the date described in Section 18(a) of the Plan.

B-1

Table of Contents

(o) *Employee* means any common-law employee of the Company or a Subsidiary or Affiliate of the Company, including Officers employed by the Company or any Subsidiary or Affiliate of the Company. Neither service as a Director nor payment of a director's fee by the Company shall, without more, constitute employment by the Company.

(p) *Exchange Act* means the Securities Exchange Act of 1934, as amended from time to time, and any successor thereto, or the rules and regulations promulgated thereunder.

(q) *Fair Market Value* means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on the American Stock Exchange Composite Tape, its Fair Market Value shall be either the mean of the highest and lowest reported sale prices of the stock (or, if no sales were reported, the average of the closing bid and asked price) or the last reported sales price of the stock, as determined by the Committee in its discretion, on the American Stock Exchange for any given day or, if not listed on such exchange, on any other national securities exchange on which the Common Stock is listed or on the NASDAQ Stock Market as reported in The Wall Street Journal or such other source as the Committee deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be either the mean between the high bid and low asked prices or the last asked price, as determined by the Committee for the Common Stock on any given day, as reported in The Wall Street Journal or such other source as the Committee deems reliable;

(iii) In the absence of an established regular public market for the Common Stock, the Fair Market Value shall be determined in good faith by the Committee and, with respect to an Incentive Stock Option, in accordance with such regulations as may be issued under the Code; provided that with respect to an individual described in Section 8(a)(i)(A) hereof, this Section 1(q)(iii) shall not be available if the resulting price fails to represent the Fair Market Value of the stock on the date of grant as determined in accordance with Sections 1(q)(i) or (ii) above.

(r) *Incentive Stock Option* means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(s) *Mature Shares* means any shares held by the Recipient for a minimum period of 6 months.

(t) *Non-Qualified Stock Option* means any Option that is not an Incentive Stock Option.

(u) *Officer*, unless otherwise noted herein, means a person who is an officer of the Company or a Subsidiary or Affiliate.

(v) *Option* means a stock option granted pursuant to the Plan.

(w) *Participant* means an Employee or Officer who holds an outstanding Award.

(x) *Performance Award* means an Award granted pursuant to Section 11(b) of the Plan.

(y) *Plan* means this Equity Award Plan.

(z) *Recipient* means an Employee or Officer who holds an outstanding Award.

(aa) *Restricted Stock* means shares of Common Stock acquired pursuant to an Award granted pursuant to Section 10 of the Plan.

(bb) *Retirement* means a Service Provider's retirement from active employment with the Company or any Subsidiary or Affiliate as determined under a pension plan of the Company or any Subsidiary or Affiliate applicable to the Service Provider; or the Service Provider's termination of employment at or after age 55 under circumstances that the Committee, in its sole discretion, deems equivalent to retirement.

Table of Contents

(cc) *Service Provider* means an Employee or Officer. A Service Provider who is an Employee shall not cease to be a Service Provider (i) during any leave of absence approved by the Company; *provided that*, for purposes of Incentive Stock Options, no such leave may exceed ninety (90) days, unless reemployment upon expiration of such leave is guaranteed by statute or contract; or (ii) as a result of transfers between locations of the Company or between the Company and any Subsidiary or Affiliate. If reemployment upon expiration of a leave of absence approved by the Company is not guaranteed by statute or contract, then on the 91st day of such leave any Incentive Stock Option held by the Recipient shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Non-Qualified Stock Option.

(dd) *Stock Appreciation Right* means an Award granted pursuant to Section 11(a) of the Plan.

(ee) *Share* means a share of the Common Stock, as adjusted in accordance with Section 14 of the Plan.

(ff) *Subsidiary* means a subsidiary corporation, whether now or hereafter existing, as defined in Section 424(f) of the Code.
SECTION 2. *Stock Subject to the Plan.*

Subject to the provisions of Section 14 of the Plan, the maximum aggregate number of Shares available for grants of Awards under the Plan is 4,000,000 Shares. The maximum aggregate number of Incentive Stock Options that may be issued under the Plan is 4,000,000. The Shares subject to an Award under the Plan may be authorized but unissued, or reacquired Common Stock or treasury shares. Except as otherwise provided in Section 14 of the Plan, no Recipient may be granted Awards in any calendar year with respect to more than 300,000 Shares. In determining the number of Shares with respect to which a Recipient may be granted an Award in any calendar year, any Award which is cancelled shall count against the maximum number of Shares for which an Award may be granted to a Recipient.

If an Award expires or becomes unexercisable without having been exercised in full, the unpurchased Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated); *provided, however*, that Shares that have actually been issued under the Plan, whether upon exercise of an Option or other Award, shall not be returned to the Plan and shall not become available for future distribution under the Plan, except that if Shares of Restricted Stock are repurchased by the Company at their original purchase price, and the original Recipient of such Shares did not receive any benefits of ownership of such Shares, such Shares shall become available for future grant under the Plan. For purposes of the preceding sentence, voting rights shall not be considered a benefit of Share ownership.

SECTION 3. *Administration of the Plan.*

(a) *Administration.* The Plan shall be administered by the Compensation Committee of the Board, or another Committee that may be appointed by the Board for this purpose in accordance with Applicable Laws. Such Committee shall consist of two or more members of the Board each of whom is a disinterested person as defined in Rule 16b-3(c)(2)(i) of the General Rules and Regulations promulgated under the Exchange Act; and all of whom, in addition, shall constitute outside directors for purposes of granting performance-based compensation awards under Treas. Reg. Sec. 1.162-27(e)(3) and Section 162(m)(4)(C) of the Code. (Such outside directors shall be appointed by, and may be removed by, such Board.) Committee members shall serve for such term(s) as the Board may determine, subject to removal by the Board at any time. The Committee shall act by a majority of its members, or if there are only two members of such Committee, by unanimous consent of both members. If at any time there is no Committee in office, the functions of the Committee specified in the Plan shall be carried out by the Board.

(b) *Powers of the Committee.* Except for the terms and conditions explicitly set forth in the Plan, the Committee shall have exclusive authority, in its discretion, to determine the Fair Market Value of the Common Stock in accordance with Section 1(q) of the Plan and to determine all matters relating to Awards under the Plan, including the selection of individuals to be granted an Award, the type of Award, the number of shares of Common Stock subject to an Award, all terms, conditions, restrictions and limitations, if any.

Table of Contents

including, without limitation, vesting, acceleration of vesting, exercisability, termination, substitution, cancellation, forfeiture, or repurchase of an Award and the terms of any instrument that evidences the Award. The Committee shall also have exclusive authority to interpret the Plan and its rules and regulations, and to make all other determinations deemed necessary or advisable under or for administering the Plan, subject to Section 16 of the Plan. All actions taken and determinations made by the Committee pursuant to the Plan shall be conclusive and binding on all parties involved or affected. The Committee may, by a majority of its members then in office, authorize any one or more of its members or any Officer of the Company to execute and deliver documents on behalf of the Committee, or delegate to an Officer of the Company the authority to make decisions pursuant to Section 8 of the Plan, *provided that* the Committee may not delegate its authority with regard to the selection for participation of or the granting of Awards to persons subject to Section 16 of the Exchange Act.

SECTION 4. *Eligibility for Awards.*

Non-Qualified Stock Options and other Awards may be granted to Employees and Officers who are Employees. In addition, an Award may be granted to a person who is offered employment by the Company, a Subsidiary or an Affiliate, *provided that* such Award shall be immediately forfeited if such person does not accept such offer of employment within such time period as the Company, Subsidiary or Affiliate may establish. If otherwise eligible, an Employee or Officer who has been granted an Option or other Award may be granted additional Options or other Awards.

SECTION 5. *Limitations on Options.*

Each Option shall be designated in the written Award Agreement as either an Incentive Stock Option or a Non-Qualified Stock Option. However, notwithstanding such designation, to the extent that the Options are amended; the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Recipient during any calendar year (under all plans of the Company and any Subsidiary or Affiliate) exceeds \$100,000; or other circumstances exist that would cause the Options to lose their status as Incentive Stock Options, such Options shall be treated as Non-Qualified Stock Options. For purposes of this Section 5, Incentive Stock Options shall be taken into account in the order in which they were granted. The Fair Market Value of the Shares shall be determined as of the time the Option with respect to such Shares is granted. If an Option is granted hereunder that is part Incentive Stock Option and part Non-Qualified Stock Option due to becoming first exercisable in any calendar year in excess of \$100,000, the Incentive Stock Option portion of such Option shall become exercisable first in such calendar year, and the Non-Qualified Stock Option portion shall commence becoming exercisable once the \$100,000 limit has been reached.

SECTION 6. *Term of Plan.*

The Plan shall become effective upon the approval by the stockholders of the Company as described in Section 16 of the Plan. It shall continue in effect for a term of ten (10) years unless terminated earlier under Section 16 of the Plan.

SECTION 7. *Term of Option.*

The term of each Option shall be stated in the Award Agreement but shall be no longer than ten (10) years from the date of grant or such shorter term as may be provided in the Award Agreement. Moreover, in the case of an Incentive Stock Option granted to a Recipient who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Subsidiary (taking into account the attribution rules under Section 424(d) of the Code), the term of the Incentive Stock Option shall be five (5) years from the date of grant or such shorter term as may be provided in the Award Agreement.

Table of Contents

SECTION 8. *Option Exercise Price and Consideration.*

(a) *Exercise Price.* The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be determined by the Committee, subject to the following:

(i) In the case of an Incentive Stock Option

(A) granted to an Employee who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Subsidiary (taking into account the attribution rules under Section 424(d) of the Code), the per Share exercise price shall be not less than 110% of the Fair Market Value per Share on the date of grant, or

(B) granted to any Employee other than an Employee described in paragraph (A) immediately above, the per Share exercise price shall be not less than 100% of the Fair Market Value per Share on the date of grant.

(ii) In the case of a Non-Qualified Stock Option, the per Share exercise price shall be not less than 100% of the Fair Market Value per Share on the date of grant.

(b) *Waiting Period and Exercise Dates.* The Committee shall have the authority, subject to the terms of the Plan, to determine any vesting restriction or limitation or waiting period with respect to any Option granted to a Recipient or the Shares acquired pursuant to the exercise of such Option.

(c) *Form of Consideration.* The Committee shall determine the acceptable form of consideration for exercising an Option, including the method of payment. In the case of an Incentive Stock Option, the Committee shall determine the acceptable form of consideration at the time of grant. Such consideration may consist entirely of:

(i) cash (in the form of a certified or bank check or such other instrument as the Company may accept);

(ii) other Mature Shares owned on the date of exercise of the Option by the Recipient (and, in the case of the exercise of a Non-Qualified Stock Option, Restricted Stock subject to an Award hereunder) based on the Fair Market Value of the Common Stock on the date the Option is exercised; *provided, however*, that in the case of an Incentive Stock Option, the right to make a payment in the form of already owned Shares may be authorized only at the time the Option is granted; and *provided that* if payment is made in the form of Restricted Stock, the number of equivalent shares of Common Stock to be received shall be subject to the same forfeiture restrictions to which such Restricted Stock was subject, unless otherwise determined by the Committee;

(iii) any combination of (i) and (ii) above;

(iv) at the discretion of the Committee, by delivery of a properly executed exercise notice together with such other documentation as the Committee and a qualified broker, if applicable, shall require to effect an exercise of the Option, and delivery to the Company of the sale or loan proceeds required to pay the exercise price, subject, however, to Section 18(f) of the Plan; or

(v) such other consideration and method of payment for the issuance of Shares to the extent permitted by the Committee and Applicable Laws.

SECTION 9. *Exercise of Option.*

(a) *Procedure for Exercise; Rights as a Stockholder.* Except as otherwise authorized by the Committee, any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Committee and set forth in the Award Agreement. If the Committee provides that any Option is exercisable only in installments, the Committee may at any time waive such installment exercise provisions, in whole or in part, based on such factors as the Committee may determine. The Committee may at any time, in whole or in part, accelerate the exercisability of any Option.

Table of Contents

An Option shall be deemed exercised when the Company receives: (i) written notice of exercise (in accordance with the Award Agreement) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised. Full payment may consist of any consideration and method of payment authorized by the Committee in accordance with Section 8(c) of the Plan and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Recipient. Until the stock certificate evidencing such Shares is issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to such Shares, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such stock certificate promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 14 of the Plan.

Exercising an Option in any manner shall decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) *Termination of Relationship as Employee or Officer.* Except as otherwise authorized by the Committee, if a Recipient ceases to be a Service Provider, other than for Cause or upon the Recipient's death, Disability or Retirement, the Recipient, subject to the restrictions of this Section 9(b), may exercise his or her Option within the time specified in this Section 9(b) to the extent that the Option is vested on the date of termination, including any acceleration of vesting granted by the Committee, and has not yet expired as set forth in the Award Agreement. Unless otherwise determined by the Committee, such Option may be exercised as follows: (i) if the Option is a Non-Qualified Stock Option, it shall remain exercisable for the lesser of the remaining term of the Option or twelve (12) months from the date of such termination of the relationship as a Service Provider; or (ii) if the Option is an Incentive Stock Option, it shall remain exercisable for the lesser of the term of the Option or three (3) months following the Recipient's termination of his relationship as a Service Provider; provided, however, that if the Recipient dies within such three-month period, any unexercised Option held by such Recipient shall notwithstanding the expiration of such three-month period continue to be exercisable (to the extent to which it was exercisable at the time of death) for the lesser of a period of twelve (12) months from the date of such death; the expiration of the stated term of such Option; or the exercise period that applies for purposes of Section 422 of the Code. If, on the date of termination, the Recipient is not vested as to his or her entire Option and the Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall revert to the Plan. If a Recipient ceases to be a Service Provider for Cause, the Option shall immediately terminate, and the Shares covered by such Option shall revert to the Plan. If, after termination, the Recipient does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

Notwithstanding the above, in the event of a Recipient's change in status from Employee to non-Employee Officer or Director, the Recipient shall not automatically be treated as if the Recipient terminated his relationship as a Service Provider, nor shall the Recipient be treated as ceasing to provide services to the Company solely as a result of such change in status. In the event a Recipient's status changes from Employee to non-Employee Officer or Director, an Incentive Stock Option held by the Recipient shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Non-Qualified Stock Option three months and one day following such change of status.

(c) *Disability of Recipient.* Except as otherwise authorized by the Committee, if, as a result of the Recipient's Disability, a Recipient ceases to be a Service Provider, the Recipient may exercise his or her Option subject to the restrictions of this Section 9(c) and within the period of time specified herein to the extent the Option is vested on the date of termination, including any acceleration of vesting granted by the Committee, and has not yet expired as set forth in the Award Agreement. Unless otherwise determined by the Committee or specified in the Award Agreement, such Option shall be exercisable for the lesser of the remaining period of time specified in the Award Agreement or twelve (12) months from the date of such termination. If, on the date of termination, the Recipient is not vested as to his or her entire Option and the

Table of Contents

Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Recipient does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan. In the event of termination of employment by reason of Disability, if an Incentive Stock Option is exercised after the expiration of the exercise periods applicable under Section 422 of the Code, such Option will thereafter be treated as a Non-Qualified Stock Option.

(d) *Death of Recipient.* Except as otherwise authorized by the Committee, if a Recipient dies while an Employee, the Option may be exercised subject to the restrictions of this Section 9(d) and within such period of time as is specified in the Award Agreement (but in no event later than the earlier of twelve (12) months from the date of such death or the expiration of the term of such Option as set forth in the Award Agreement), but only to the extent that the Option is vested on the date of death, including any acceleration of vesting granted by the Committee, and has not yet expired as set forth in the Award Agreement. If, at the time of death, the Recipient is not vested as to his or her entire Option and the Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall immediately revert to the Plan. The Option may be exercised by the executor or administrator of the Recipient's estate or, if none, by the person(s) entitled to exercise the Option under the Recipient's will or the applicable laws of descent or distribution. If the Option is not so exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan. In the event of termination of employment by reason of death, if an Incentive Stock Option is exercised after the expiration of the exercise periods that apply for purposes of Section 422 of the Code, such Option will thereafter be treated as a Non-Qualified Stock Option.

(e) *Retirement of Recipient.*

(i) *Non-Qualified Stock Options.* Except as otherwise authorized by the Committee, if, as a result of the Recipient's Retirement, a Recipient ceases to be a Service Provider, the Recipient may, subject to the restrictions of this Section 9(e), exercise his or her Non-Qualified Stock Option within the time specified herein to the extent the Option is vested on the date of termination, including any acceleration of vesting granted by the Committee, and has not yet expired as set forth in the Award Agreement. Unless otherwise determined by the Committee, such Option may be exercised for the lesser of the remaining period of time specified in the Award Agreement or three (3) years following the Recipient's Retirement. Notwithstanding the foregoing, if the Recipient dies within such three (3)-year (or shorter) period, any unexercised Non-Qualified Stock Option held by such Recipient shall, notwithstanding the expiration of such period, continue to be exercisable to the extent to which it was exercisable at the time of death for a period of twelve (12) months from the date of death or the expiration of the stated term of such Option, whichever period is shorter.

(ii) *Incentive Stock Options.* If the Recipient holds an Incentive Stock Option and ceases to be a Service Provider by reason of his or her Retirement, such Incentive Stock Option may continue to be exercisable by the Recipient to the extent to which it was exercisable at the time of Retirement for a period of three (3) months from the date of Retirement or the expiration of the stated term of such Option, whichever period is the shorter. Notwithstanding the foregoing, if the Recipient dies within such three-month period, any unexercised Incentive Stock Option held by such Recipient shall, notwithstanding the expiration of such period, continue to be exercisable to the extent to which it was exercisable at the time of death for a period of twelve (12) months from the date of such death; the expiration of the stated term of such Option; or the exercise period that applies for purposes of Section 422 of the Code, whichever period is the shorter. If, on the date of termination due to Retirement, the Recipient is not vested as to his or her entire Option and the Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination due to Retirement, the Option is not exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

Table of Contents

(f) *Cash out Provisions.* On receipt of written notice of exercise, the Committee may elect, but shall not be required to, to cash out all or any part of the shares of Common Stock for which an Option is being exercised by paying the Recipient an amount, in cash, equal to the excess of the Fair Market Value of the Common Stock over the option price times the number of shares of Common Stock for which an Option is being exercised on the effective date of such cash out. Cash outs pursuant to this Section 9(f) relating to Options held by Recipients who are actually or potentially subject to Section 16(b) of the Exchange Act shall comply with the provisions of Section 16 of the Exchange Act and the rules promulgated thereunder, to the extent applicable.

SECTION 10. *Restricted Stock.*

(a) *Awards of Restricted Stock.* Shares of Restricted Stock may be issued either alone, in addition to, or in tandem with other Awards granted under the Plan and/or cash awards made outside of the Plan. The Committee shall determine the individuals to whom it will award Restricted Stock under the Plan, and it shall advise the Recipient in writing, by means of an Award Agreement, of the terms, conditions and restrictions related to the Award, including the number of Shares to be awarded to the Recipient, the time or times within which such Awards may be subject to forfeiture and any other terms and conditions of the Awards, in addition to those contained in this Section 10. The Committee may condition the grant or vesting of Restricted Stock upon the attainment of specified performance goals of the Recipient or of the Company, Subsidiary or Affiliate for or within which the Recipient is primarily employed, or upon such other factors as the Committee shall determine. The provisions of an Award need not be the same with respect to each Recipient. The terms of the Award of Restricted Stock shall comply in all respects with Applicable Law and the terms of the Plan.

(b) *Awards and Certificates.* Each Award shall be confirmed by, and subject to the terms of, an Award Agreement. Shares of Restricted Stock shall be evidenced in such manner as the Committee may deem appropriate, including book-entry registration or issuance of one or more stock certificates. The Committee may require that the certificates evidencing such Shares be held in custody by the Company until the restrictions thereon shall have lapsed and that, as a condition of any Award of Restricted Stock, the Recipient shall have delivered to the Company a stock power, endorsed in blank, relating to the Common Stock covered by such Award. Any certificate issued with respect to Shares of Restricted Stock shall be registered in the name of such Recipient and shall bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Award, substantially in the following form:

The transferability of this certificate and the shares of Stock represented hereby are subject to the terms and conditions (including forfeiture) of the Danielson Holding Corporation Equity Award Plan for Employees and Officers and an Award Agreement. Copies of such Plan and Award Agreement are on file at the office of the Secretary of Danielson Holding Corporation. If and when the Restriction Period (hereinafter defined) expires without a prior forfeiture of the Restricted Stock subject to such Restriction Period, the Recipient may request that unlegended certificates for such Shares be delivered to the Recipient.

(c) *Terms and Conditions.* Shares of Restricted Stock shall be subject to the following terms and conditions:

(i) *Restriction Period.* Subject to the provisions of the Plan and the terms of the Award Agreement, during a period set by the Committee, commencing with the date of such Award (the Restriction Period), the Recipient shall not be permitted to sell, assign, transfer, pledge or otherwise encumber Shares of Restricted Stock (the Restrictions). The Committee may provide for the lapse of such Restrictions in installments or otherwise and may accelerate or waive such Restrictions, in whole or in part, in each case based on period of service, performance of the Recipient or of the Company, Subsidiary or Affiliate, division or department for which the Recipient is employed or such other factors or criteria as the Committee may determine. Notwithstanding the foregoing, if the Recipient of a Restricted Stock Award is subject to the provisions of Section 16 of the Exchange Act, shares of Common Stock subject to the grant may not, without the written consent of the Committee, be sold or otherwise disposed of within six (6) months following the date of grant. The Committee may, in its

Table of Contents

discretion, impose a limit on the number of Shares that a Recipient may receive in any twelve (12)-month period in an Award of Restricted Stock.

(ii) *Rights.* Except as provided in Section 10(c) of the Plan, the applicable Award Agreement and Applicable Law, the Recipient shall have, with respect to the Shares of Restricted Stock, all of the rights of a stockholder of the Company holding the class or series of Common Stock that is the subject of the Award Agreement, including, if so provided in the Award Agreement, the right to vote the Shares and the right to receive any cash dividends. Unless otherwise determined by the Committee in the applicable Award Agreement and subject to Section 18(e) of the Plan, for the Restriction Period, (A) cash dividends on the Shares of Common Stock that are the subject of the Award Agreement shall be automatically deferred and reinvested in additional Restricted Stock and (B) dividends payable in Common Stock shall be paid in the form of Restricted Stock. If there is a *pro rata* distribution of warrants or other rights to acquire shares of Common Stock, then the Recipient shall have the right to participate in or receive such warrants or other rights, *provided, however*, that any shares of Common Stock acquired pursuant to the exercise of such warrants or other rights shall be subject to the same vesting requirements and restrictions as the underlying Common Stock.

(iii) *Termination of Service Provider Relationship.* Except to the extent otherwise provided in the applicable Award Agreement or the Plan, if a Recipient ceases to be a Service Provider for any reason during the Restriction Period, all Shares still subject to restriction shall be forfeited by the Recipient. Without limiting the foregoing, an Award Agreement may, at the Committee's discretion, allow for vesting to continue after termination of employment with the Company, provided the Recipient remains an Employee of any Subsidiary or Affiliate of the Company.

(d) *Other Provisions.* The Award Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Committee in its sole discretion, including, without limitation, provisions relating to tax matters including wage withholding requirements; prohibitions on elections by the Recipient under Section 83(b) of the Code; and gross-up payments to Recipients to satisfy tax liabilities. In addition, the terms of the Award Agreements for Restricted Stock need not be the same with respect to each Recipient.

SECTION 11. *Deferral of Stock Award.*

(a) The Committee may, in its sole discretion, authorize an Employee or Officer to elect to defer the ownership of the Shares of Common Stock otherwise issuable pursuant to Section 10. Any such election shall be made in writing in the form prescribed by the Committee, and shall be subject to such rules and procedures as shall be determined by the Committee in its sole discretion. In no event, however, shall any deferral be permitted to the extent prohibited by Applicable Laws.

(b) An election to defer pursuant to (a) above with respect to Shares of Restricted Stock issuable in a calendar year must be made on or prior to December 31st of the year that precedes the year in which such Restricted Stock would otherwise be issued. Notwithstanding the foregoing, an Employee or Officer may make an election to defer pursuant to this Section 11 no later than 30 days after the Effective Date, for the year in which the Employees Plan is first effective, or, if later, within 30 days after the date the Employee or Officer first becomes eligible to participate.

(c) At the time of the deferral election described in this Section 11, the Employee or Officer may select the date for the issuance or receipt of the deferred Shares. If the Employee or Officer does not select a date for the issuance of deferred Shares, the deferred Shares will be issued upon termination of his or her service as an Employee or Officer.

Table of Contents

SECTION 12. *Other Awards.*

The Committee, in its sole discretion, but subject to the terms of the Plan, may grant the following types of Awards (in addition to or in combination with the Awards of Options and Restricted Stock described above) under this Plan on a stand alone, combination or tandem basis:

(a) *Stock Appreciation Right.* The Committee may grant a right to receive the excess of the Fair Market Value of a Share on the date the stock appreciation right is exercised over the Fair Market Value of a Share on the date the stock appreciation right was granted (the Spread). The Spread with respect to a stock appreciation right may be payable in cash, Shares with a total Fair Market Value equal to the Spread or a combination of these two. With respect to stock appreciation rights that are subject to Section 16 of the Exchange Act, however, the Committee shall retain sole discretion (i) to determine the form in which payment of the stock appreciation right will be made (cash, Shares or any combination thereof) or (ii) to approve an election by a Recipient to receive cash in full or partial settlement of stock appreciation rights. Each Award Agreement for stock appreciation rights shall provide that stock appreciation rights under the Plan may not be exercised earlier than six (6) months from the date of grant. The terms of the Award Agreements granting stock appreciation rights need not be the same with respect to each Recipient. A stock appreciation right shall be subject to adjustment as provided in Section 14 of the Plan.

(b) *Performance Award.* The Committee may grant a Performance Award based on the performance of the Recipient over a specified performance period. A Performance Award may be awarded to an Employee contingent upon future performance of the Company or any Affiliate, Subsidiary, division or department thereof in which such Employee is employed, if applicable, during the performance period. The Committee shall establish the performance measures applicable to such performance prior to the beginning of the performance period, but subject to such later revisions as the Committee may deem appropriate to reflect significant, unforeseen events or changes. The Performance Award may consist of a right to receive Shares (or cash in an amount equal to the Fair Market Value thereof) or the right to receive an amount equal to the appreciation, if any, in the Fair Market Value of Shares over a specified period. Each Performance Award shall have a maximum value established by the Committee at the time such Award is made. In determining the value of Performance Awards, the Committee shall take into account the Recipient's responsibility level, performance, potential, other Awards and such other considerations as it deems appropriate. Payment of a Performance Award may be made following the end of the performance period in cash, Shares (based on the Fair Market Value on the payment date) or a combination thereof, as determined by the Committee, and in a lump sum or installments as determined by the Committee. Except as otherwise provided in an Award Agreement or as determined by the Committee, a Performance Award shall terminate if the Recipient does not remain continuously in the employ of the Company at all times during the applicable performance period. The terms of the Award Agreements granting a Performance Award need not be the same with respect to each Recipient.

(c) *Other Stock-Based Awards.* The Committee may, in its discretion, grant other Share-based Awards which are related to or serve a similar function to those Awards set forth in this Section 12.

SECTION 13. *Non-Transferability of Awards.*

Unless otherwise specified by the Committee in the Award Agreement, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by (i) will or by the laws of descent or distribution or (ii) pursuant to a qualified domestic relations order (as defined in the Code or Title I of the Employee Retirement Income Security Act of 1974, as amended, or the rules thereunder). Options and other Awards may be exercised, during the lifetime of the Participant, only by the Participant or by the guardian or legal representative of the Participant or by an alternate payee pursuant to a qualified domestic relations order. If the Committee makes an Award transferable, such Award shall contain such additional terms and conditions as the Committee deems appropriate. Any attempt to assign, pledge or otherwise transfer any Award or of any right or privileges conferred thereby, contrary to the Plan, or the sale or levy or similar process upon the rights and privileges conferred hereby, shall be void.

Table of Contents

SECTION 14. *Adjustments Upon Changes in Capitalization.*

Subject to any required action by the stockholders of the Company, the number of shares of Common Stock covered by each outstanding Award, and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share of Common Stock covered by each such outstanding Award, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that (a) conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration; and (b) no adjustment shall be made below par value and no fractional shares of Common Stock shall be issued. Such adjustment shall be made by the Board in its sole discretion, whose determination in that respect shall be final, binding and conclusive. In the event of an extraordinary cash dividend, the Committee may, in its sole discretion, equitably adjust the aggregate number of Shares available under the Plan, as well as the exercise price, number of Shares and other appropriate terms of any outstanding Award in order to preserve the intended benefits of the Plan. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

SECTION 15. *Date of Grant.*

The date of grant of an Award shall be, for all purposes, the date on which the Committee makes the determination granting such Award, or such other later date as is determined by the Committee. Notice of the determination shall be provided to each Participant within a reasonable time after the date of such grant.

SECTION 16. *Term; Amendment and Termination of the Plan.*

(a) *Amendment and Termination.* Subject to this Section 16 and Section 18(f), the Board may at any time amend, alter, suspend or terminate the Plan, including without limitation to provide for the transferability of any or all Options to comply with or take advantage of rules governing registration of shares. Subject to Section 18(f) and the other terms of the Plan, the Committee may amend the terms of any Option theretofore granted, prospectively or retroactively, but no such amendment shall impair the rights of any Recipient without the Recipient's consent.

(b) *Stockholder Approval.* The Company shall obtain stockholder approval of any material Plan amendment and any amendment to the extent necessary and desirable to comply with Section 422 of the Code (or any successor rule or statute or other applicable law, rule or regulation, including the requirements of any exchange or quotation system on which the Common Stock is listed or quoted). Such stockholder approval, if required, shall be obtained in such a manner and to such a degree as is required by the Applicable Law, rule or regulation.

(c) *Effect of Amendment or Termination.* No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Recipient, unless mutually agreed otherwise between the Recipient and the Committee, which agreement must be in writing and signed by the Recipient and the Company.

SECTION 17. *Conditions Upon Issuance of Shares.*

(a) *Legal Compliance.* Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, Applicable Laws, and the requirements of any stock exchange or quotation system upon which the Shares may then be listed or quoted and shall be further subject to the approval of counsel for the Company with respect to such compliance. The Committee may cause a legend or legends to be placed on any certificates for Shares or other securities delivered under the Plan as it may deem appropriate to make reference to such legal rules and restrictions, or to impose any restrictions on transfer.

Table of Contents

(b) *Withholding Obligations.* No later than the date as of which an amount first becomes includible in the gross income of the Recipient for federal income tax purposes with respect to any Award under the Plan, the Recipient shall pay to the Company, or make arrangements satisfactory to the Company regarding the payment of, any federal, state, local or foreign taxes of any kind required by law to be withheld with respect to such amount. Unless otherwise determined by the Committee, withholding obligations may be settled with vested Common Stock, including vested Common Stock that is part of the Award that gives rise to the withholding requirement. The obligations of the Company under the Plan shall be conditioned on such payment or arrangements, and the Company, its Subsidiaries and its Affiliates shall, to the extent permitted by law, have the right to deduct any such taxes from any payment otherwise due to the Recipient. The Committee may establish such procedures as it deems appropriate, including the making of irrevocable elections, for the settlement of withholding obligations with vested Common Stock.

(c) *Inability to Obtain Authority.* The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

(d) *Grants Exceeding Allotted Shares.* If the Stock covered by an Award exceeds, as of the date of grant, the number of Shares which may be issued under the Plan without additional stockholder approval, such Award shall be void with respect to such excess Shares, unless stockholder approval of an amendment sufficiently increasing the number of Shares subject to the Plan is timely obtained in accordance with Applicable Law and Section 16(b) of the Plan.

SECTION 18. *General Provisions.*

(a) *Term of Plan.* This Plan shall become effective upon its approval by the stockholders of the Company (Effective Date), subject to the approval of the Company's stockholders on or before the first anniversary of the date of its adoption by the Board. Such stockholder approval shall be obtained in the manner and to the degree required under Applicable Laws and the rules of any stock exchange upon which the Common Stock is listed. It shall continue in effect for a term of ten (10) years unless terminated earlier under Section 16 of the Plan.

(b) *No Contract of Employment.* Neither the Plan nor any Award hereunder shall confer upon any individual any right with respect to continuing such individual's employment relationship with the Company, nor shall they interfere in any way with such individual's right or the Company's right to terminate such employment relationship at any time, with or without cause.

(c) *Severability.* In the event that any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

(d) *Governing Law.* The Plan and all Awards made and actions thereunder shall be governed by and construed in accordance with the laws of the state of Delaware.

(e) *Dividends.* The reinvestment of dividends in additional Restricted Stock at the time of any dividend payment shall be permissible only if sufficient shares of Common Stock are available under the Plan for such reinvestment (taking into account then outstanding Options and other Awards).

(f) *Prohibition on Loans to Participants.* The Company shall not lend funds to any Participant for the purpose of paying the exercise or base price associated with any Award or for the purpose of paying any taxes associated with the exercise or vesting of an Award.

(g) *Performance-Based Compensation.* The Committee may designate any Award as performance-based compensation for purposes of Section 162(m) of the Code. Any Awards designated as performance-based compensation shall be conditioned on the achievement of one or more performance measures, and the measurement may be stated in absolute terms or relative to comparable companies.

Table of Contents

(h) *Unfunded Status of Plan.* It is intended that the Plan constitute an unfunded plan for incentive and deferred compensation. The Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver Common Stock or make payment; provided, however, that, unless the Committee otherwise determines, the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

(i) *Liability of Committee Members.* Except as provided under Applicable Law, no member of the Board or the Committee will be liable for any action or determination made in good faith by the Board or the Committee with respect to the Plan or any Award under it. Neither the Company, the Board of Directors nor the Committee, nor any Subsidiary or Affiliate, nor any directors, officers or employees thereof, shall be liable to any Participant or other person if it is determined for any reason by the Internal Revenue Service or any court that an Incentive Stock Option granted hereunder does not qualify for tax treatment as an incentive stock option under Section 422 of the Code.

Table of Contents

APPENDIX C

DANIELSON HOLDING CORPORATION

EQUITY AWARD PLAN FOR DIRECTORS

Table of Contents**TABLE OF CONTENTS**

	Page
SECTION 1. Purpose; Definitions	C-1
(a) Administrator	C-1
(b) Affiliate	C-1
(c) Applicable Laws	C-1
(d) Award	C-1
(e) Award Agreement	C-1
(f) Board	C-1
(g) Cause	C-1
(h) Code	C-1
(i) Committee	C-1
(j) Common Stock	C-1
(k) Company	C-1
(l) Director	C-1
(m) Disability	C-1
(n) Effective Date	C-1
(o) Employee	C-1
(p) Exchange Act	C-2
(q) Fair Market Value	C-2
(r) Mature Shares	C-2
(s) Non-Qualified Stock Option	C-2
(t) Option	C-2
(u) Participant	C-2
(v) Plan	C-2
(w) Recipient	C-2
(x) Restricted Stock	C-2
(y) Stock Appreciation Right	C-2
(z) Share	C-2
(aa) Subsidiary	C-2
SECTION 2. Stock Subject to the Plan	C-2
SECTION 3. Administration of the Plan	C-3
(a) Administration	C-3
(b) Powers of the Committee	C-3
SECTION 4. Eligibility for Awards	C-3
SECTION 5. Term of Plan	C-3
SECTION 6. Limitations on Options	C-3
SECTION 7. Director Stock Options	C-3
(a) Option Awards	C-3
(b) Eligibility	C-3
(c) Amendment	C-4
SECTION 8. Term of Option	C-4

Table of Contents

	Page
SECTION 9. Option Exercise Price and Consideration	C-4
(a) Exercise Price	C-4
(b) Waiting Period and Exercise Dates	C-4
(c) Form of Consideration	C-4
SECTION 10. Exercise of Option	C-4
(a) Procedure for Exercise; Rights as a Stockholder	C-4
(b) Termination of Relationship as Director	C-5
(c) Death of Recipient	C-5
(d) Cash out Provisions	C-5
SECTION 11. Restricted Stock	C-5
(a) Awards of Restricted Stock	C-5
(b) Awards and Certificates	C-6
(c) Terms and Conditions	C-6
(d) Other Provisions	C-7
SECTION 12. Deferral of Stock Award	C-7
SECTION 13. Other Awards	C-7
(a) Stock Appreciation Right	C-7
(b) Other Stock-Based Awards	C-7
SECTION 14. Non-Transferability of Awards	C-7
SECTION 15. Adjustments Upon Changes in Capitalization	C-8
SECTION 16. Date of Grant	C-8
SECTION 17. Term, Amendment and Termination of the Plan	C-8
(a) Amendment and Termination	C-8
(b) Stockholder Approval	C-8
(c) Effect of Amendment or Termination	C-8
SECTION 18. Conditions Upon Issuance of Shares	C-8
(a) Legal Compliance	C-8
(b) Inability to Obtain Authority	C-9
(c) Grants Exceeding Allotted Shares	C-9
SECTION 19. General Provisions	C-9
(a) Term of Plan	C-9
(b) Severability	C-9
(c) Governing Law	C-9
(d) Dividends	C-9
(e) Prohibition on Loans to Participants	C-9
(f) Unfunded Status of Plan	C-9
(g) Liability of Committee Members	C-9

Table of Contents

DANIELSON HOLDING CORPORATION

EQUITY AWARD PLAN FOR DIRECTORS

SECTION 1. *Purpose; Definitions.*

The purposes of this Plan are to promote the interests of the Company (including any Subsidiaries and Affiliates) and its stockholders by using equity interests in the Company to attract, retain and motivate its non-employee directors and to encourage and reward their contributions to the Company's performance and profitability.

The following capitalized terms shall have the following respective meanings when used in this Plan:

- (a) *Administrator* means the Board or any one of its Committees as shall be administering the Plan, in accordance with Section 3 of the Plan.
- (b) *Affiliate* means any corporation or other entity controlled by the Company and designated by the Committee as such.
- (c) *Applicable Laws* means the legal requirements relating to the administration of plans providing one or more of the types of Awards described in the Plan and the issuance of Shares thereunder pursuant to U.S. state corporate laws, U.S. federal and state securities laws, the Code and the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.
- (d) *Award* means a grant of an Option, Restricted Stock, stock appreciation right or other stock-based Award under the Plan, all on a stand alone, combination or tandem basis, as described in or granted under the Plan.
- (e) *Award Agreement* means a written agreement between the Company and a Participant evidencing the terms and conditions of an individual Award. The Award Agreement is subject to the terms and conditions of the Plan.
- (f) *Board* means the Board of Directors of the Company.
- (g) *Cause* shall mean, unless otherwise determined by the Committee, (i) the conviction of the Recipient for committing, or the entering of a plea of *nolo contendere* by the Recipient with respect to, a felony under federal or state law or crime involving moral turpitude; (ii) dishonesty in the course of fulfilling the Recipient's director duties; or (iii) willful misconduct or the deliberate failure on the part of the Recipient to perform his or her director duties in any material respect.
- (h) *Code* means the Internal Revenue Code of 1986, as amended or replaced from time to time.
- (i) *Committee* means the Compensation Committee of the Board, or another committee appointed by the Board to administer the Plan, in accordance with Section 3 of the Plan.
- (j) *Common Stock* means the common stock, par value \$0.10, of the Company.
- (k) *Company* means Danielson Holding Corporation, a Delaware corporation.
- (l) *Director* means a director serving on the Board of the Company who is not also an Employee of the Company or any Subsidiary or Affiliate thereof and who has been duly elected to the Board by the stockholders of the Company or by the Board under applicable corporate law. Neither service as a Director nor payment of a director's fee by the Company shall, without more, constitute employment by the Company.
- (m) *Disability* means permanent and total disability as determined under procedures established by the Committee for the purposes of the Plan.
- (n) *Effective Date* means the date described in Section 19(a) of the Plan.

Edgar Filing: IMAX CORP - Form 10-K/A

(o) *Employee* means any person, including an officer, employed by the Company or any Subsidiary or Affiliate of the Company; provided, however, that a person serving solely as an interim officer of the Company or any Subsidiary or Affiliate of the Company shall not be deemed an Employee

C-1

Table of Contents

for the purposes of the Plan. Neither service as a Director nor payment of a director's fee by the Company shall, without more, constitute employment by the Company.

(p) *Exchange Act* means the Securities Exchange Act of 1934, as amended from time to time, and any successor thereto, or the rules and regulations promulgated thereunder.

(q) *Fair Market Value* means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on the American Stock Exchange Composite Tape, its Fair Market Value shall be either the mean of the highest and lowest reported sale prices of the stock (or, if no sales were reported, the average of the closing bid and asked price) or the last reported sale price of the stock, as determined by the Committee in its discretion, on the American Stock Exchange for any given day or, if not listed on such exchange, on any other national securities exchange on which the Common Stock is listed or on the NASDAQ Stock Market, as reported in The Wall Street Journal or such other source as the Committee deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be either the mean between the high bid and low asked prices or the last asked price, as determined by the Committee for the Common Stock on any given day, as reported in The Wall Street Journal or such other source as the Committee deems reliable;

(iii) In the absence of an established regular public market for the Common Stock, the Fair Market Value shall be determined in good faith by the Committee.

(r) *Mature Shares* means any shares held by the Recipient for a minimum period of six (6) months.

(s) *Non-Qualified Stock Option* means any Option that is not an incentive stock option (i.e., an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder).

(t) *Option* means a stock option granted pursuant to the Plan.

(u) *Plan* means this Equity Award Plan for Directors.

(v) *Recipient* means a Director or former Director, if applicable, who holds an outstanding Award.

(w) *Restricted Stock* means shares of Common Stock acquired pursuant to an Award granted pursuant to Section 11 of the Plan.

(x) *Stock Appreciation Right* means an Award granted pursuant to Section 13(a) of the Plan.

(y) *Share* means a share of the Common Stock, as adjusted in accordance with Section 15 of the Plan.

(z) *Subsidiary* means a subsidiary corporation, whether now or hereafter existing, as defined in Section 424(f) of the Code.

SECTION 2. *Stock Subject to the Plan.*

Subject to the provisions of Section 15 of the Plan, the maximum aggregate number of Shares available for grants of Awards under the Plan is 400,000 Shares. The Shares subject to an Award under the Plan may be authorized but unissued, or reacquired Common Stock or treasury shares. In determining the number of Shares with respect to which a Recipient may be granted an Award in any calendar year, any Award which is cancelled shall count against the maximum number of Shares for which an Award may be granted to a Recipient.

If an Award expires or becomes unexercisable without having been exercised in full, the unpurchased Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the

Table of Contents

Plan has terminated); *provided, however*, that Shares that have actually been issued under the Plan, whether upon exercise of an Option or other Award, shall not be returned to the Plan and shall not become available for future distribution under the Plan, except that if Shares of Restricted Stock are repurchased by the Company at their original purchase price, and the original Recipient of such Shares did not receive any benefits of ownership of such Shares, such Shares shall become available for future grant under the Plan. For purposes of the preceding sentence, voting rights shall not be considered a benefit of Share ownership.

SECTION 3. *Administration of the Plan.*

(a) *Administration.* The Plan shall be administered by the Compensation Committee of the Board or another Committee that may be appointed by the Board for this purpose in accordance with Applicable Laws. Such Committee shall consist of two or more members of the Board each of whom is a disinterested person, as defined in Rule 16b-3(c)(2)(i) of the General Rules and Regulations promulgated under the Exchange Act. Committee members shall serve for such term(s) as the Board may determine, subject to removal by the Board at any time. The Committee shall act by a majority of its members, or, if there are only two members of such Committee, by unanimous consent of both members. If at any time there is no Committee in office, the functions of the Committee specified in the Plan shall be carried out by the Board.

(b) *Powers of the Committee.* Except for the terms and conditions explicitly set forth in the Plan, the Committee shall have exclusive authority, in its discretion, to determine the Fair Market Value of the Common Stock in accordance with Section 1(q) of the Plan and to determine all matters relating to Awards under the Plan, including the selection of individuals to be granted an Award, the type of Award, the number of shares of Common Stock subject to an Award, all terms, conditions, restrictions and limitations, if any, including, without limitation, vesting, acceleration of vesting, exercisability, termination, substitution, cancellation, forfeiture or repurchase of an Award and the terms of any instrument that evidences the Award. The Committee shall also have exclusive authority to interpret the Plan and its rules and regulations, and to make all other determinations deemed necessary or advisable under or for administering the Plan, subject to Section 17 of the Plan. All actions taken and determinations made by the Committee pursuant to the Plan shall be conclusive and binding on all parties involved or affected. The Committee may, by a majority of its members, authorize any one or more of its members or any Officer of the Company to execute and deliver documents on behalf of the Committee. No Director who is a member of the Committee shall participate in any action of the Committee with respect to any claim or dispute involving such Director.

SECTION 4. *Eligibility for Awards.*

Directors shall be eligible for Awards under the Plan in accordance with the terms of the Plan.

SECTION 5. *Term of Plan.*

The Plan shall become effective upon the approval by the stockholders of the Company as described in Section 17 of the Plan. It shall continue in effect for a term of ten (10) years unless terminated earlier under Section 17 of the Plan.

SECTION 6. *Limitations on Options.*

Each Option shall be designated in the written Award Agreement for an individual Director as a Non-Qualified Stock Option. The Fair Market Value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

SECTION 7. *Director Stock Options.*

(a) *Option Awards.* The Committee in its sole discretion, but subject to the terms of the Plan, may grant Options under this Plan either alone, in combination or in tandem with any other Awards under this Plan.

(b) *Eligibility.* An Option described under Section 7(a) of the Plan shall be granted hereunder only if, as of each date of grant (or, in the case of any initial grant, from and after the effective date of the Plan), the Director (i) is not otherwise an Employee of the Company or any Subsidiary or Affiliate, and (ii) has served on the Board continuously since the commencement of his or her term.

Table of Contents

SECTION 8. *Term of Option.*

The term of each Option shall be stated in the Award Agreement but shall be no later than ten (10) years from the date of grant or such shorter term as may be provided in the Award Agreement. An Option may not be exercised until six months after the date the Option is granted.

SECTION 9. *Option Exercise Price and Consideration.*

(a) *Exercise Price.* The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be determined by the Committee, but shall be not less than 100% of the Fair Market Value per Share on the effective date of grant.

(b) *Waiting Period and Exercise Dates.* The Committee shall have the authority, subject to the terms of the Plan, to determine any vesting restriction or limitation or waiting period with respect to any Option granted to a Recipient or the Shares acquired pursuant to the exercise of such Option.

(c) *Form of Consideration.* The Committee shall determine the acceptable form of consideration for exercising an Option, including the method of payment. Such consideration may consist entirely of:

(i) cash (in the form of a certified or bank check or such other instrument as the Company may accept);

(ii) other Mature Shares owned by the Recipient on the date of exercise of the Option (and Restricted Stock subject to an Award hereunder) based on the Fair Market Value of the Common Stock on the date the Option is exercised; *provided, however*, that if payment is made in the form of Restricted Stock, the number of equivalent shares of Common Stock to be received shall be subject to the same forfeiture restrictions to which such Restricted Stock was subject, unless otherwise determined by the Committee;

(iii) any combination of (i) and (ii) above;

(iv) at the discretion of the Committee, by delivery of a properly executed exercise notice together with such other documentation as the Committee and a qualified broker, if applicable, shall require to effect an exercise of the Option, and delivery to the Company of the sale or loan proceeds required to pay the exercise price; or

(v) such other consideration and method of payment for the issuance of Shares to the extent permitted by the Committee and Applicable Laws.

SECTION 10. *Exercise of Option.*

(a) *Procedure for Exercise; Rights as a Stockholder.* Except as otherwise authorized by the Committee, any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Committee and set forth in the Award Agreement. If the Committee provides that any Option is exercisable only in installments, the Committee may at any time waive such installment exercise provisions, in whole or in part, based on such factors as the Committee may determine. The Committee may at any time, in whole or in part, accelerate the exercisability of any Option.

An Option shall be deemed exercised when the Company receives: (i) written notice of exercise (in accordance with the Award Agreement) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised. Full payment may consist of any consideration and method of payment authorized by the Committee in accordance with Section 9(c) of the Plan and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Recipient. Until the stock certificate evidencing such Shares is issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to such Shares, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such stock certificate promptly after the Option is exercised. No adjustment will be made for a dividend or other right for

Table of Contents

which the record date is prior to the date the stock certificate is issued, except as provided in Section 15 of the Plan.

Exercising an Option in any manner shall decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) *Termination of Relationship as Director.* Except as otherwise authorized by the Committee, if a Recipient ceases to be a Director, other than for Cause, the Recipient, subject to the restrictions of this Section 10(b) and to the extent that the Option is vested on the date of termination of service as a Director, including any acceleration of vesting granted by the Committee, may exercise his or her Option for the lesser of the remaining term of the Option or three (3) years from the date of such termination of the service as a Director. If, on the date of termination, the Recipient is not vested as to his or her entire Option and the Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, on the date of termination, the Recipient is not vested as to his or her entire Option and the Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall revert to the Plan. If a Recipient ceases to be a Director for Cause, the Option shall immediately terminate, and the Shares covered by such Option shall revert to the Plan. If, after termination, the Recipient does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(c) *Death of Recipient.* If a Recipient dies while a Director, the Option may be exercised subject to the restrictions of this Section 10(c) and within such period of time as is specified in the Award Agreement (but in no event later than the earlier of three (3) years or the expiration of the term of such Option as set forth in the Award Agreement), but only to the extent that the Option is vested on the date of death, including any acceleration of vesting granted by the Committee, and has not yet expired as set forth in the Award Agreement. If, at the time of death, the Recipient is not vested as to his or her entire Option and the Committee has not granted any acceleration of vesting, the Shares covered by the unvested portion of the Option shall immediately revert to the Plan. The Option may be exercised by the executor or administrator of the Recipient's estate or, if none, by the person(s) entitled to exercise the Option under the Recipient's will or the applicable laws of descent or distribution. If the Option is not so exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(d) *Cash out Provisions.* On receipt of written notice of exercise, the Committee may elect to, but shall not be required to, cash out all or any part of the shares of Common Stock for which an Option is being exercised by paying the Recipient an amount, in cash, equal to the excess of the Fair Market Value of the Common Stock over the option price times the number of shares of Common Stock for which an Option is being exercised on the effective date of such cash out. Cash outs pursuant to this Section 10(c) shall comply with the provisions of Section 16 of the Exchange Act and the rules promulgated thereunder, to the extent applicable.

SECTION 11. *Restricted Stock.*

(a) *Awards of Restricted Stock.* Shares of Restricted Stock may be issued either alone, in addition to, or in tandem with other Awards granted under the Plan and/or cash awards made outside of the Plan. The Committee shall determine the individuals to whom it will award Restricted Stock under the Plan, and it shall advise the Recipient in writing, by means of an Award Agreement, of the terms, conditions and restrictions related to the Award, including the number of Shares to be awarded to the Recipient, the time or times within which such Awards may be subject to forfeiture and any other terms and conditions of the Awards, in addition to those contained in this Section 11. The Committee may condition the grant or vesting of Restricted Stock upon the attainment of specified performance goals of the Company, or upon such other factors as the Committee shall determine. The provisions of an Award need not be the same with respect to each Recipient. The terms of the Award of Restricted Stock shall comply in all respects with Applicable Laws and the terms of the Plan.

Table of Contents

(b) *Awards and Certificates.* Each Award shall be confirmed by, and subject to the terms of, an Award Agreement. Shares of Restricted Stock shall be evidenced in such manner as the Committee may deem appropriate, including book-entry registration or issuance of one or more stock certificates. The Committee may require that the certificates evidencing such Shares be held in custody by the Company until the restrictions thereon shall have lapsed and that, as a condition of any Award of Restricted Stock, the Recipient shall have delivered to the Company a stock power, endorsed in blank, relating to the Common Stock covered by such Award. Any certificate issued with respect to Shares of Restricted Stock shall be registered in the name of such Recipient and shall bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Award, substantially in the following form:

The transferability of this certificate and the shares of Stock represented hereby are subject to the terms and conditions (including forfeiture) of the Danielson Holding Corporation Equity Award Plan for Directors and an Award Agreement. Copies of such Plan and Award Agreement are on file at the office of the Secretary of Danielson Holding Corporation.

If and when the Restriction Period (hereinafter defined) expires without a prior forfeiture of the Restricted Stock subject to such Restriction Period, the Recipient may request that unlegended certificates for such Shares shall be delivered to the Recipient.

(c) *Terms and Conditions.* Shares of Restricted Stock shall be subject to the following terms and conditions:

(i) *Restriction Period.* Subject to the provisions of the Plan and the terms of the Award Agreement, during a period set by the Committee, commencing with the date of such Award (the Restriction Period), the Recipient shall not be permitted to sell, assign, transfer, pledge or otherwise encumber Shares of Restricted Stock (the Restrictions). The Committee may provide for the lapse of such Restrictions in installments or otherwise and may accelerate or waive such Restrictions, in whole or in part, in each case based on period of service, performance of the Company or such other factors or criteria as the Committee may determine. Notwithstanding the foregoing, if the Recipient of a Restricted Stock Award is subject to the provisions of Section 16 of the Exchange Act, shares of Common Stock subject to the grant may not, without the written consent of the Committee, be sold or otherwise disposed of within six (6) months following the date of grant. The Committee may, in its discretion, impose a limit on the number of Shares that a Recipient may receive in any twelve (12)-month period in an Award of Restricted Stock.

(ii) *Rights.* Except as provided in Section 11(c) of the Plan, the Award Agreement and Applicable Law, the Recipient shall have, with respect to the Shares of Restricted Stock, all of the rights of a stockholder of the Company holding the class or series of Common Stock that is the subject of the Award Agreement, including, if so provided in the Award Agreement, the right to vote the Shares and the right to receive any cash dividends. Unless otherwise determined by the Committee in the applicable Award Agreement and subject to Section 19(d) of the Plan, for the Restriction Period, (A) cash dividends on the Shares of Common Stock that are the subject of the Award Agreement shall be automatically deferred and reinvested in additional Restricted Stock and (B) dividends payable in Common Stock shall be paid in the form of Restricted Stock. If there is a *pro rata* distribution of warrants or other rights to acquire shares of Common Stock, then the Recipient shall have the right to participate in or receive such warrants or other rights, *provided, however*, that any shares of Common Stock acquired pursuant to the exercise of such warrants or other rights shall be subject to the same vesting requirements and restrictions as the underlying Common Stock.

(iii) *Termination of Service as a Director.* Except to the extent otherwise provided in the applicable Award Agreement or the Plan, if a Recipient ceases to be a Director for any reason during the Restriction Period, all Shares still subject to restriction shall be forfeited by the Recipient.

(d) *Other Provisions.* The Award Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Committee in its sole discretion, including, without limitation, provisions relating to tax matters; prohibitions on elections by the Recipient under

Table of Contents

Section 83(b) of the Code. In addition, the terms of the Award Agreements for Restricted Stock need not be the same with respect to each Recipient.

SECTION 12. *Deferral of Stock Award.*

(a) The Committee may, in its sole discretion, authorize a Director to elect to defer the ownership of the Shares of Common Stock otherwise issuable pursuant to Section 11. Any such election shall be made in writing in the form prescribed by the Committee, and shall be subject to such rules and procedures as shall be determined by the Committee in its sole discretion. In no event, however, shall any deferral be permitted to the extent prohibited by Applicable Laws.

(b) An election to defer pursuant to (a) above with respect to Shares of Restricted Stock issuable in a calendar year must be made on or prior to December 31st of the year that precedes the year in which such Restricted Stock would otherwise be issued. Notwithstanding the foregoing, a Director may make an election to defer pursuant to this Section 12 no later than 30 days after the Effective Date, for the year in which the Directors Plan is first effective, or, if later, within 30 days after the date the Director first becomes eligible to participate.

(c) At the time of deferral, a Director may select the date for the issuance or receipt of the deferred Shares. If a Director does not select a date for the issuance of deferred Shares, the deferred Shares will be issued upon termination of his or her service as a Director.

SECTION 13. *Other Awards.*

The Committee, in its sole discretion, but subject to the terms of the Plan, may grant the following types of Awards (in addition to or in combination with the Awards of Options and Restricted Stock described above) under this Plan on a stand alone, combination or tandem basis:

(a) *Stock Appreciation Right.* The Committee may grant a right to receive the excess of the Fair Market Value of a Share on the date the stock appreciation right is exercised over the Fair Market Value of a Share on the date the stock appreciation right was granted (the Spread). The Spread with respect to a stock appreciation right may be payable in cash, Shares with a total Fair Market Value equal to the Spread or a combination of these two. With respect to stock appreciation rights that are subject to Section 16 of the Exchange Act, however, the Committee shall retain sole discretion (i) to determine the form in which payment of the stock appreciation right will be made (cash, Shares or any combination thereof) or (ii) to approve an election by a Recipient to receive cash in full or partial settlement of stock appreciation rights. Each Award Agreement for stock appreciation rights shall provide that stock appreciation rights under the Plan may not be exercised earlier than six (6) months from the date of grant and shall specify the effect of a termination of service as a Director on the exercisability of the stock appreciation rights. The terms of the Award Agreements granting stock appreciation rights need not be the same with respect to each Recipient. A stock appreciation right shall be subject to adjustment as provided in Section 15 of the Plan.

(b) *Other Stock-Based Awards.* The Committee may, in its discretion, grant other Share-based Awards which are related to or serve a similar function to those Awards set forth in this Section 13.

SECTION 14. *Non-Transferability of Awards.*

Unless otherwise specified by the Committee in the Award Agreement, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by (i) will or by the laws of descent or distribution or (ii) pursuant to a qualified domestic relations order (as defined in the Code or Title I of the Employee Retirement Income Security Act of 1974, as amended, or the rules thereunder). Options and other Awards may be exercised, during the lifetime of the Participant, only by the Participant or by the guardian or legal representative of the Participant or by an alternate payee pursuant to a qualified domestic relations order. If the Committee makes an Award transferable, such Award shall contain such additional terms and conditions as the Committee deems appropriate. Any attempt to assign, pledge or otherwise transfer any Award or of any right or privileges conferred thereby, contrary to the Plan, or the sale or levy or similar process upon the rights and privileges conferred hereby, shall be void.

Table of Contents

SECTION 15. *Adjustments Upon Changes in Capitalization.*

Subject to any required action by the stockholders of the Company, the number of shares of Common Stock covered by each outstanding Award, and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share of Common Stock covered by each such outstanding Award, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; *provided, however,* that (a) conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration ; (b) the dilution effect of the Shares authorized, plus the shares reserved for issuance pursuant to all other stock-related plans of the Company, shall not exceed 10%; and (c) no adjustment shall be made below par value and no fractional shares of Common Stock shall be issued. Such adjustment shall be made by the Board in its sole discretion, whose determination in that respect shall be final, binding and conclusive. In the event of an extraordinary cash dividend, the Committee may, in its sole discretion, equitably adjust the aggregate number of Shares available under the Plan, as well as the exercise price, number of Shares and other appropriate terms of any outstanding Award in order to preserve the intended benefits of the Plan. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

SECTION 16. *Date of Grant.*

The date of grant of an Award shall be, for all purposes, the date on which the Committee makes the determination granting such Award, or such other later date as is determined by the Committee. Notice of the determination shall be provided to each Director receiving such Award within a reasonable time after the date of such grant.

SECTION 17. *Term, Amendment and Termination of the Plan.*

(a) *Amendment and Termination.* Subject to this Section 17 and Section 19(e), the Board may at any time amend, alter, suspend or terminate the Plan, including without limitation to provide for the transferability of any or all Options to comply with or take advantage of rules governing registration of shares. Subject to Section 19(e) and the other terms of the Plan, the Committee may amend the terms of any Option theretofore granted, prospectively or retroactively, but no such amendment shall impair the rights of any Recipient without the Recipient's consent.

(b) *Stockholder Approval.* The Company shall obtain stockholder approval of any material Plan amendment and any amendment to the extent necessary and desirable to comply with Section 422 of the Code (or any successor rule or statute or other applicable law, rule or regulation, including the requirements of any exchange or quotation system on which the Common Stock is listed or quoted). Such stockholder approval, if required, shall be obtained in such a manner and to such a degree as is required by Applicable Laws, rules or regulations.

(c) *Effect of Amendment or Termination.* No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Recipient, unless mutually agreed otherwise between the Recipient and the Committee, which agreement must be in writing and signed by the Recipient and the Company.

SECTION 18. *Conditions Upon Issuance of Shares.*

(a) *Legal Compliance.* Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, Applicable Laws, and the requirements of any stock exchange or quotation system upon which the Shares may then be listed or quoted and shall be further subject to the

Table of Contents

approval of counsel for the Company with respect to such compliance. The Committee may cause a legend or legends to be placed on any certificates for Shares or other securities delivered under the Plan as it may deem appropriate to make reference to such legal rules and restrictions, or to impose any restrictions on transfer.

(b) *Inability to Obtain Authority.* The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

(c) *Grants Exceeding Allotted Shares.* If the Stock covered by an Award exceeds, as of the date of grant, the number of Shares which may be issued under the Plan without additional stockholder approval, such Award shall be void with respect to such excess Shares, unless stockholder approval of an amendment sufficiently increasing the number of Shares subject to the Plan is timely obtained in accordance with Applicable Law and Section 17(b) of the Plan.

SECTION 19. *General Provisions.*

(a) *Term of Plan.* This Plan shall become effective upon its approval by the stockholders of the Company (Effective Date), subject to the approval of the Company's stockholders on or before the first anniversary of the date of its adoption by the Board. Such stockholder approval shall be obtained in the manner and to the degree required under Applicable Laws and the rules of any stock exchange upon which the Common Stock is listed. It shall continue in effect for a term of ten (10) years unless terminated earlier under Section 17 of the Plan.

(b) *Severability.* In the event that any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

(c) *Governing Law.* The Plan and all Awards made and actions thereunder shall be governed by and construed in accordance with the laws of the state of Delaware.

(d) *Dividends.* The reinvestment of dividends in additional Restricted Stock at the time of any dividend payment shall be permissible only if sufficient shares of Common Stock are available under the Plan for such reinvestment (taking into account then outstanding Options and other Awards).

(e) *Prohibition on Loans to Participants.* The Company shall not lend funds to any Director for the purpose of paying the exercise or base price associated with any Award or for the purpose of paying any taxes associated with the exercise or vesting of an Award.

(f) *Unfunded Status of Plan.* It is intended that the Plan constitute an unfunded plan for incentive and deferred compensation. The Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver Common Stock or make payment; provided, however, that, unless the Committee otherwise determines, the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

(g) *Liability of Committee Members.* Except as provided under Applicable Law, no member of the Board or the Committee will be liable for any action or determination made in good faith by the Board or the Committee with respect to the Plan or any Award under it.

Table of Contents

ANNUAL MEETING OF STOCKHOLDERS OF

Danielson Holding Corporation

October 5, 2004

Please date, sign and mail
your proxy card in the
envelope provided as soon
as possible.

â Please detach along perforated line and mail in the envelope provided. â

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF DIRECTORS AND
FOR PROPOSALS 2, 3 AND 4.
PLEASE SIGN, DATE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE. PLEASE MARK
YOUR VOTE IN BLUE OR BLACK INK AS SHOWN HERE x**

1. The Board of Directors recommends a vote FOR the listed nominees.

- | NOMINEES: | |
|--|----------------------|
| <input type="radio"/> FOR ALL NOMINEES | ï David M. Barse |
| | ï Ronald J. Broglio |
| <input type="radio"/> WITHHOLD AUTHORITY
FOR ALL NOMINEES | ï Peter C. B. Bynoe |
| | ï Richard L. Huber |
| | ï William C. Pate |
| <input type="radio"/> FOR ALL EXCEPT | ï Jean Smith |
| (See instructions below) | ï Joseph P. Sullivan |
| | ï Clayton Yeutter |

INSTRUCTION: To withhold authority to vote for any individual nominee(s), mark **FOR ALL EXCEPT** and fill in the circle next to each nominee you wish to withhold, as shown here: 1

To change the address on your account, please check the box at right and indicate your new address in the address space above. Please note that changes to the registered name(s) on the account may not be

submitted via this method.

	FOR	AGAINST	ABSTAIN
2. To approve the Equity Award Plan for Employees and Officers.	o	o	o
3. To approve the Equity Award Plan for Directors.	o	o	o
4. To ratify the appointment of Ernst & Young LLP as the Company's independent auditors for the 2004 fiscal year.	o	o	o
5. Any other matters which may properly come before the Meeting or any adjournment or postponement thereof in the discretion of the proxy holder.	o	o	o

YOUR VOTE IS IMPORTANT!

PLEASE VOTE, SIGN, DATE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.

Signature of Stockholder

Date:

Signature of Stockholder

Date:

Note: Please sign exactly as your name or names appear on this Proxy. When shares are held jointly, each holder should sign. When signing as executor, administrator, attorney, trustee or guardian, please give full title as such. If the signer is a corporation, please sign full corporate name by duly authorized officer, giving full title as such. If signer is a partnership, please sign in partnership name by authorized person.

Table of Contents

DANIELSON HOLDING CORPORATION

**The Roosevelt Hotel, 45 East Forty Fifth Street
New York, New York 10017**

Proxy for Annual Meeting of Stockholders Solicited on Behalf of the Board of Directors

The undersigned stockholder of Danielson Holding Corporation, a Delaware corporation (the Company), hereby appoints PHILIP G. TINKLER and DAVID S. STONE, or either of them, with full power of substitution in each of them, to attend the Annual Meeting of Stockholders of the Company (the Meeting) to be held on October 5, 2004, at 11:00 A.M., Eastern Daylight Time, and any adjournment or postponement thereof, to cast on behalf of the undersigned all votes that the undersigned is entitled to cast at the Meeting and otherwise to represent the undersigned at the Meeting with all powers possessed by the undersigned if personally present at the Meeting. The undersigned hereby acknowledges receipt of the Notice of Annual Meeting of Stockholders and of the accompanying Proxy Statement and revokes any proxy heretofore given with respect to the Meeting.

The votes entitled to be cast by the undersigned will be cast as instructed on the reverse side hereof. If this proxy is executed but no instruction is given, the votes entitled to be cast by the undersigned will be cast for each of the nominees for director as described in the Proxy Statement, for approval of the Equity Award Plan for Employees and Officers, for approval of the Equity Award Plan for Directors and for the ratification of the appointment of Ernst & Young LLP as the Company's independent auditors and in the discretion of the proxy holder on any other matter that may properly come before the Meeting or any adjournment or postponement thereof.

(Continued and to be signed on the reverse side)