

## ***THE MANY FACETED M&A LAWYER***

It helps, of course, to have attended law school; but for many of the crucial roles M&A lawyers are called upon to play nowadays, some other form of higher education — usually obtained through on-the-job training — may be equally significant.

Many areas of legal practice are difficult, though I can't think of any as complex as mergers and acquisitions. But what's interesting about the M&A complexity is that much of it derives from disciplines not traditionally considered basic to a lawyer's makeup.

The strictly legal questions in M&A work, while tricky enough — and with judicial outcomes that may be far from predictable — are rarely obscure or tortuous. And, for the most part, the skills commonly associated with the legal profession — such as drafting agreements and disclosure documents, conducting due diligence reviews — play an important, but far from exceptional role.

To be fair, the litigation aspect — meat and potatoes for the bar — is absolutely central in the realm of contested takeovers. Here, lawyers do what they're trained for, with a lot riding on the outcome of crucial motions, and intense time pressure compressing what might otherwise be months of discovery, depositions, brief writing and motion practice into a couple of weeks.

Also, on the traditional front, mergers test a lawyer's negotiating skills to the utmost. Unfortunately, not all

lawyers are superior negotiators, although those who ply this particular trade should be.

Still, an abundance of non-traditional roles — ranging from public relations expert to financial whiz to psychologist — exert a continual tug on the M&A lawyer, who (at least in these areas) is often flying by the seat of his pants.

Here are ten such roles I've identified.

**1. Financial Whiz.** It wasn't so long ago that, when you asked a lawyer working on a public acquisition, "What does the \$58.50 per share work out to, in terms of total dollars to be paid by the acquiror?", he would look back at you with a blank stare — as if to say, "Why are you bothering me with those *numbers*?" He was, after all, the *lawyer*; his area of expertise was the *legal* part of the deal; and numbers — even such crucial ones as the purchase price — were simply items that he plugged in to the proxy statement once the financial people worked them out.

(In a way, one could draw an analogy between that attitude and the disdain many lawyers used to show for *billing*. Somehow, it was beneath them professionally to have to deal with such matters of *commerce*; as a result, unbilled time would just keep accumulating — sometimes, even after the case was over. We all know how *that* has now changed!)

Well, it's a different world today in the public arena, particularly in connection with contested deals. So many of the significant conceptual points and key tactical decisions are financial or numbers-driven, to wit: comparing values between a partial and an any-and-all offer, or between one complex security and another; deciding how much the present worth of a security can be changed by tinkering with such variables as interest rate and sinking fund; determining how many shares will move from one receptacle to another at various offered prices; and even trying to figure out how a poison pill would really *work*, if

tested! Questions involving figures are simply omnipresent. Lawyers who duck them — who close their eyes, claiming, “Hey, these are ‘financial’ matters, and I never even took accounting in law school” — are missing out on much of the tactical and negotiating action.

As a result, budding M&A lawyers with a joint J.D./M.B.A. background start with a significant advantage in their grasp of matters financial. Single sheepskin associates shouldn’t be too concerned, though, since the current big-bucks mania on Wall Street seems to be luring many of these twin-degree worthies out of the law firm closet into the heady world of investment banking.

Finance is an area where the appearance of omniscience may block useful information from entering your brain. Not that I advocate gaping like a dummy in front of your client or adversary; but, in the privacy of your office or on a phone line, it’s perfectly okay to seek some guidance on what’s being discussed among the financial types, in order to appreciate the significance of various permutations. In other words, you’re allowed to ask the investment banker, “Hey, Joe, tell me why this discounted cash flow analysis comes out so differently from using the current earnings multiple.”

Your reading habits can undergo some changes also. Reading about the trials and tribulations — the triumphs and goofs — of your legal colleagues in the new-style periodicals is great sport, to be sure; but in terms of a learning experience, devouring in-depth pieces about the deals currently being done which appear in the *financial press* — exploring the rationale behind the numbers — may actually be of greater practical benefit.

**2. Public Relations Expert.** I came from the old school, which considered the financial press as strictly an annoyance, to be avoided if possible — but, in any case, relatively neutral in terms of substantive significance.

“You don’t win this one in the newspapers,” was the classic refrain. Most of the time, you ducked reporters, putting out only whatever bare minimum press releases were legally required.

There was, to be sure, a legal dimension to this approach — a good deal of concern over such potential SEC problems as gun-jumping and pre-solicitation activities (which today seem more honored in the breach). The operative by-word then was, “The less said, the better.”

In recent years, however, I’ve learned how out-of-date that view is — especially in a contested (or potentially contested) acquisition. The reason is simple: what appears in the newspaper can have a major impact, pro or con, on what you’re trying to accomplish. In today’s world, individuals and institutions in a position to take actions that might affect your deal not only read the papers, but act on what they read. I don’t just mean your average Joe, with a few shares at risk — I’m talking about arbitrageurs, other parties to a deal or contest, potential bidders, regulatory agencies, and even judges who end up deciding important transactional issues (boy, do I have a story to tell about *that!*). And the inescapable fact is that everyone else in the deal is getting in his licks — telling the story *his* way, with his emphasis and his nuances.

Let’s face it, reporters are always looking for a hook to hang their story on; and the players who know how to feed reportorial appetites come off looking very good indeed. It’s not that newsmen are biased; it’s that they take their news where they find it. A reporter can’t build his story around your client’s declining to comment — which, in addition, often carries with it a flavor of guilty knowledge on the client’s part.

I was handling a big deal not long ago for a company whose executives didn’t know how to play the financial press, but were up against several masters of the craft. We were getting crucified in the papers; our side of the story

wasn't getting out, and it was costing us. What the hell, I decided, we can't do worse than we're doing now. So I started to talk to reporters; and all of a sudden, a lot more balance began to appear in the news items.

I felt this was a proper role for a lawyer to be playing. I was able to decide whether it was an appropriate day to make any comment at all (on many days, official silence was still the wisest course), or whether I wanted my remarks to be strictly on background, with no attribution to the company — perhaps just “a source close to the negotiations” — or semi-anonymous (attributed to an unnamed spokesman for the company), or, if I thought something positive needed saying, coming from me directly — provided the reporter read the quote back to me for a final check. These are just the kinds of judgments that should be made by a lawyer, who is trained to refrain from saying things that can come back to bite his client in the behind.

Of course, the lawyer has to have enough of a public relations sense to know what to say (and what to avoid). A good financial public relations consultant can be helpful here, as can the investment banker.

Once the reporters knew I was willing to hear them out, they would contact me when something significant happened, or even when they had gotten some choice information from one of the other parties, thereby giving me a chance to tell our side of the story — an opportunity we might not have had if our *modus operandi* was official silence. And it's no secret that any rebuttal you make has to appear in the *same* article as the other guy's charge — tomorrow is too late, since investors have already acted upon the first story and your after-the-fact response comes across sounding weak and defensive.

Some players in the M&A game do their best negotiating in the press — sending all kinds of signals, justifying their positions, and so on. When you see something in the

paper like, “Sources indicate that Consolidated will have to raise its price to win the Silicon deal, or it risks getting a reputation for blowing the big ones,” or “Conglomerate is reported to have offered Target an additional \$3 per share if Target would go quietly,” rest assured, these musings didn’t just pop out of thin air — somebody is out there doing his thing, and you’re well-advised to level the playing field.

**3. Writer.** In a similar vein, today’s M&A lawyers need to be able to string words together with some real sensitivity to the nuances. Attorneys accustomed to writing dry-as-dust prospectuses or drafting clear-but-cold agreements may not necessarily be skilled in manipulating the English language around tricky corners and into meaningful nooks and crannies.

Moreover, bare bones press releases can easily be misconstrued by reporters and readers. Nor can you rely on things being fleshed out in subsequent interviews between reporter and executive — they may miss connections, and anyway, you can never be sure what the executive will say.

So, if you’ve got something to put out — such as justifying, through a logical explanation, why your client took the action he did — then take the time to write it out yourself. Don’t worry that the press release may run to some length; I did one that came to 11 pages, but as a result, the papers played the story just the way I wanted them to.

It’s not only writings intended for the press that call on these particular skills. Other documents, of less defined stripe than an agreement, require a subtle touch. Take the so-called “bear-hug” letter, by which an aggressor attempts simultaneously to court a prospective target and to threaten putting the company into play. [See the prior essay, “The Acquisition Mating Dance.”] What

message do you want to get across? How close can you come to committing your client, without actually doing so? What do you say in order to make the other side worried about having to make a public disclosure, while still giving their lawyer enough ammunition to advise his client that they don't have to speak out should negotiations get started? And so on.

You don't need to be Herman Melville — and I'm not suggesting that "creative" writing is the order of the day — but a little attention to prose style is definitely called for.

**4. Psychologist.** To the financial world, they may appear to be companies; but in the trenches, many of these entities are little more than the extended personality of one or two individuals. And the ability to predict how these protagonists will react to certain stimuli, or to foresee their next move, or to figure out how to persuade them to move in your direction — or even just to devise a means of getting someone to meet with your client — is a constant preoccupation at the higher levels of deal-making.

Here's an area where we're all amateurs, and yet it's extremely rare to get help from a psychiatrist or other professional trained in psychological counseling — even though their use has become relatively common in such areas as jury selection.

So, it often falls to the lawyer — who is expected to be good at such things, perhaps because of his experience at the negotiating table — to peer deeply into the mind of the key person on the other side. The problem is, though, that you may *not* be sitting across the table from your adversary — a much broader gulf (both in spatial and motivational terms) often separates the combatants. And the useful psychological insights you have picked up through bargaining over the years — strictly on a seat-of-

the-pants basis — may be less useful in the context of utilizing force to achieve or resist unshared goals.

By the way, it's not just understanding the motivations and hot buttons of the guy on the *other* side of the deal; it's those of your own client, too. Lawyers who operate on the premise that abstract rationality dictates all reactions and movements in the emotion-laden world of corporate takeovers do so at their peril.

**5. Moralist.** A traditional role for the lawyer is keeper of the corporate conscience — deciding what behavior will pass muster and what flips over the line. In the old days, however, this task was much more straightforward than at present. The conflict of interest issues today are very subtle and slippery, often lacking ready precedents. So, we find ourselves playing the role of moralist — imposing on the client the lawyer's own notion of what's good and bad — what passes and what flunks our individual smell test.

Here's the conflict between the controlling shareholder's stock interest and his board seat; there's the conflict between the CEO's continued employment and his role as chairman of the board; and everywhere are the myriad conflicts arising in the context of an LBO — it's not always clear who's buying and who's selling! — which are particularly tough for the lawyer in the middle.

These conflicts play right into such tough questions as, “Do we sell the Company or try to stay independent?” or “Can we negotiate the CEO's employment contract before we've reached a deal on the merger?” or “Should management come in with its best bid on the LBO the first time around?” — all of which ultimately end up demanding Solomon-like judgment from — who else? — the lawyer.

Ethics we can handle, but morality — that may be another matter.

**6. Employee Benefits Consultant.** Along the same lines, some of the most perplexing issues faced by counsel in an acquisition involve the personal benefits to be received by members of the acquired company's management. And it's not so much a matter of negotiating those benefits with the *acquiring* corporation; rather, it's a question of the employment contract or severance arrangement that the executive works out in advance with his *own* company — usually with the blessing of the compensation committee of the board of directors.

But before anything goes to the committee, it's up to management to formulate the specific terms — and that's where the lawyer comes in. What's appropriate under the circumstances? Should the executive get three years' salary in the event he's canned, or only two? Should the benefits include a tax gross-up if the numbers exceed the IRS guidelines and trigger the prohibitive tax?

These would be tough questions for expert employee benefit consultants; they're even tougher for a non-expert lawyer caught in the middle between an executive who's anxious about job security and fair treatment, and the board (the lawyer's ultimate client) which will undoubtedly ask counsel his opinion of the terms and whether they'll stand up if challenged in the courts.

It's no good to punt — you have to speak out on these issues. And the really tough part comes when you think management has gotten a little too greedy — which is definitely *not* what they want to hear coming from their lawyer.

**7. Stock Market Analyst.** So many of the moves made in a public acquisition are geared to their effect on the stock market. "If we bid \$50, will the arbs go for it?" "How much higher do we have to go to get the stock flowing in?" "How many shares can we pick up if we do a Street sweep?"

Now, what's likely to happen in the market is the particular bailiwick of investment banking firms, but it's by no means an exact science; and sometimes your guess is as good as the next banker's. Moreover, you need to appreciate how the market works, or you'll find yourself proffering a suggestion that others hoot down on the grounds that it won't fly with the market professionals.

My word of advice here is, don't formulate plans that only work if the market behaves in a predictable manner — you'll be doomed to disappointment. Instead, stay flexible, ready to jump in a different direction and pull your irons out of the fire if — as so often is the case — the market action simply defies rational analysis.

**8. Businessman.** Just as the line between law and finance has become blurred, so the distinction between legal and business issues is no longer clear-cut.

For example, many acquisitions today depend on the acquiror's ability to sell off big chunks of the target's assets in order to pay down the debt incurred to make the acquisition. The lawyer needs to get actively involved in this business planning, in order to be able to assess the likelihood of his client accomplishing this task — to say nothing of passing on the adequacy of the applicable disclosures in the tender offer papers or proxy statements.

Similarly, lawyers representing targets and white knights have to deal with the question of whether some key segment of the seller's business can be separately encapsulated, to serve as the basis for a "crown jewel" option intended to lock up the deal as against the hostile bidder and all other contenders. Crown jewels — which are usually negotiated in the heat of battle, under great pressure to come to a rapid determination — have become a hot target for litigious disgruntled suitors, who attack the price, directorial due care, and the bid-chilling

aspects of the option. Real business problems abound here, involving valuation, the severability of the unit, the ability of the target to function without it, and so on. The lawyers must appreciate the business realities involved in order to structure the transaction to withstand legal attack.

**9. Generalissimo.** In the context of contested takeovers, the analogies between running a deal and conducting a military campaign are often frightening. The lingo is that of war; the attitudes of the combatants may well be similar to hostile belligerents; and the strategic and tactical thinking is much more von Clausewitz than Albert Schweitzer.

To be sure, other traditional lawyers' functions sometimes approximate aspects of warfare. Any litigation involves combat; still, its typical concern with past events, its non-monopolization of management attention, and its lack of certain more subtle dimensions analogize more to a single battle than an extended campaign. Negotiations may approximate the diplomacy that often accompanies warfare, but lack the mood of imminent peril should the talks fail, as well as the sense of total mobilization.

With a takeover, however, you get the feeling you're in the middle of World War II. There are allies and foes, pitched battles and periods of anticipation, intelligence operations, problems with lines of supply, diplomatic initiatives, moves taken to win over the "hearts and minds," threats, bluffs, and so on.

For those of us who were too young for World War II, in college during Korea, and too old for Viet Nam — and for everyone else with unsated bellicose impulses — this takeover stuff is hard to put down — especially since there are no draftees, and regardless of the outcome (in contrast to the real thing), you come back in one piece and well-compensated for your time and trouble.

10. **Seer.** It used to be that the rules of the game were clearly marked out, and your job was to lead the client by the hand in complying. But now, it's not always clear what rules we're playing by.

This became most apparent in 1986 in the realm of taxes. Everyone knew there were changes in the wind that could greatly alter the shape of things, but no one was sure what would emerge from Congress — both on a substantive level, and also in terms of retroactivity.

So, we were all playing the role of seer then, trying to peer into the future and figure out what was going to happen. And the stakes were high. If the desired tax treatment wasn't going to be available — for instance, in the case of a company selling its assets in the course of what was formerly a Section 337 liquidation — the net difference could run into many millions of dollars.

If we *knew* the old treatment wasn't going to be available, then perhaps we could have designed around it (at some financial loss, or decrease of flexibility, to be sure) or conducted negotiations to spread the damage around, so to speak. But we didn't know that, which left us in a terrible pickle.

All we could do was gather the best information available on the mood of the Congress; explain the situation to our client; have him say, "What do you think we ought to do?"; take a stab at a solution; gulp as we saw it implemented; and hold our breath, hoping the bill came out the right way.

This all goes to the issue of the lawyer's predictive function — traditionally, one of his strong points. Being able to tell a client how something is likely to come out separates the professional from the layman; and while it's by no means the whole of lawyering, it furnishes a sturdy foundation on which to base considerations of strategy and approach. In today's fast-paced world, that foundation is eroding.

I might add that the lawyer's predictive function vis-a-vis takeover litigation — again, one of his classic strong points — is also a bit shaky now, in view of some surprising decisions and judicial language that isn't always crystal clear. Put a bunch of lawyers together in a room, and try to get them to agree on just how the Delaware court is likely to come out on the *next* set of facts it's faced with — you'll see exactly what I mean.

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So, there it is — a quiver of skills that no one ever told you, back then, you would need, but which in large part serves to make M&A practice something special.



# Duke Energy and Progress Energy to Merge

## Jan. 10, 2011

CHARLOTTE, N.C. AND RALEIGH, N.C. -

- \$26 Billion Transaction Will Create Nation's Largest Utility with a Combined Enterprise Value of \$65 Billion
- Diversified Generation Portfolio in Six Regulated Service Territories
- Transaction Expected to be Accretive to Adjusted Diluted Earnings in First Year

Duke Energy (NYSE: DUK) and Progress Energy, Inc. (NYSE: PGN) announced today that both companies' boards of directors have unanimously approved a definitive merger agreement to combine the two companies in a stock-for-stock transaction. The combined company, to be called Duke Energy, will be the country's largest utility, with:

- Approximately \$65 billion in enterprise value and \$37 billion in market capitalization
- The country's largest regulated customer base, providing service to approximately 7.1 million electric customers in six regulated service territories North Carolina, South Carolina, Florida, Indiana, Kentucky and Ohio
- Approximately 57 gigawatts of domestic generating capacity from a diversified mix of coal, nuclear, natural gas, oil and renewable resources
- The largest regulated nuclear fleet in the country.

"Our industry is entering a building phase where we must invest in an array of new technologies to reduce our environmental footprints and become more efficient," said Jim Rogers, chairman, president and chief executive officer of Duke Energy. "By merging our companies, we can do that more economically for our customers, improve shareholder value and continue to grow.

"Combining Duke Energy and Progress Energy creates a utility with greater financial strength and enhanced ability to meet our challenges head-on," Rogers continued.

"This combination of two outstanding companies is a natural fit," said Bill Johnson, chairman, president and chief executive officer of Progress Energy. "It makes clear strategic sense and creates exceptional value for our shareholders. Together, we can leverage our best practices to achieve even higher levels of safety, operational excellence and customer satisfaction, and save money for customers by combining our fuel purchasing power and the dispatch of our generating plants.

"This merger also provides predictable earnings and cash flows to support our dividend payments to shareholders," Johnson added.

### Terms

Under the merger agreement, Progress Energy's shareholders will receive 2.6125 shares of common stock of Duke Energy in exchange for each share of Progress Energy common stock. Based on Duke Energy's closing share price on Jan. 7, 2011, Progress Energy shareholders would receive a value of \$46.48 per share, or \$13.7 billion in total equity value.

Duke Energy also will assume approximately \$12.2 billion in Progress Energy net debt. The transaction price represents a 7.1 percent premium to the unaffected closing stock price of Progress Energy on Jan. 5, 2011, and a 3.9 percent premium to the closing stock price of Progress Energy on Jan. 7, 2011.

The transaction price also represents a 6.6 percent premium to the average closing stock price of Progress Energy over the last 20 trading days ending Jan. 5, 2011, and a 6.4 percent premium over the last 20 trading days ending Jan. 7, 2011.

Following completion of the merger, officials anticipate Duke Energy shareholders will own approximately 63 percent of the combined company and Progress Energy shareholders will own approximately 37 percent on a fully diluted basis.

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Duke Energy and Progress Energy to M...

The combination is anticipated to be accretive to Duke Energy's adjusted earnings in the first year after closing.

Based on Duke Energy's current quarterly cash dividend of 24.5 cents per common share, Progress Energy shareholders would receive an approximate 3 percent dividend increase.

Duke Energy expects to effect a reverse stock split immediately prior to closing, and, as a result, the exchange ratio will be appropriately adjusted at that time to reflect the reverse split.

#### Structure, Organization & Leadership

When the merger is completed, Rogers will become executive chairman of the new organization. In this role, Rogers will advise the CEO on strategic matters, play an active role in government relations and serve as the company's lead spokesperson on energy policy.

Johnson will become president and chief executive officer of the new company.

Both Rogers and Johnson will serve on the board of directors of the combined company, which will be composed of 18 members, with 11 designated by Duke Energy's board of directors and seven designated by Progress Energy's board of directors.

The combined company will be headquartered in Charlotte and will maintain substantial operations in Raleigh.

Until the merger has received all necessary approvals and has closed, the companies will continue to operate as separate entities.

Customers will see no change in their current electric utility companies including: Progress Energy Carolinas and Progress Energy Florida and Duke Energy Carolinas, Duke Energy Indiana, Duke Energy Ohio, Duke Energy Kentucky, Commercial Power, Duke Energy Generation Services and Duke Energy International.

#### Approvals & Timing

Completion of the merger is conditioned upon, among other things, the approval of the shareholders of both companies, as well as expiration or termination of any applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

Other necessary regulatory filings include: Federal Energy Regulatory Commission (FERC), Nuclear Regulatory Commission (NRC), North Carolina Utilities Commission (NCUC) and South Carolina Public Service Commission (SCPSC).

The companies also will provide information regarding the merger to their other state regulators: the Florida Public Service Commission, Indiana Utility Regulatory Commission, Kentucky Public Service Commission and Ohio Public Utilities Commission.

The companies are targeting a closing by the end of 2011.

#### Advisors

J.P. Morgan served as lead financial advisor and provided a fairness opinion to Duke Energy, and BofA Merrill Lynch also provided a fairness opinion to Duke Energy. Lazard Frères served as lead financial advisor and provided a fairness opinion to Progress Energy, and Barclays Capital also served as a financial advisor and provided a fairness opinion to Progress Energy. Wachtell, Lipton, Rosen & Katz served as legal counsel for Duke Energy. Hunton & Williams LLP served as legal counsel for Progress Energy.

#### Conference Call & Webcast

Rogers and Johnson will discuss the combination of the two companies on a conference call today at 10 a.m. EST.

The call will be available by telephone and audio webcast. The speakers will discuss information presented in handouts that are available through the Duke Energy or Progress Energy investor websites. Participants are encouraged to access the handouts before the teleconference begins.

**Webcast Instructions:** To gain access to the webcast, which will be listen-only, please go to [www.duke-energy.com/investors](http://www.duke-energy.com/investors) (<http://www.duke-energy.com/investors>) or [www.progress-energy.com](http://www.progress-energy.com) (<http://www.progress-energy.com>) and click on the audio webcast link. Please log on to the website at least 10 minutes prior to the call to register and download and install any necessary audio software. A replay of the webcast also will be available beginning at 1 p.m. today for two weeks.

**Teleconference Instructions:** The telephone number for today's teleconference is 1-800-458-9009 for U.S. callers (1-719-325-duke-energy.com/.../2011011001.asp

## **Goldman Sachs to Acquire Zilkha Renewable Energy**

NEW YORK -- The Goldman Sachs Group (NYSE: GS) has agreed to acquire Zilkha Renewable Energy ("Zilkha"), a privately held wind energy development firm based in Houston, Texas, the two companies announced today.

The transaction is subject to regulatory approvals and is expected to close in the second quarter of 2005. The sale price was not disclosed.

Zilkha Renewable Energy, owned by the father-and-son team of Selim and Michael Zilkha, is one of the nation's leading independent wind energy development companies, with a portfolio of nearly 4,000 megawatts in various stages of development in a dozen states. Goldman Sachs will acquire 100% of Zilkha's interests in the 200-megawatt Flat Rock Wind Power Project in Lewis County, New York, as well as 100% of Zilkha's interest in the 150-megawatt Blue Canyon Phase II Project in Oklahoma, both of which are expected to be completed by the end of 2005.

"Goldman Sachs is already a global leader in the energy field, with major positions in traditional energy development, power marketing and commodities trading, and energy finance. Building on our existing portfolio of wind energy assets is a logical extension of our strategy," said Henry M. Paulson, Jr., Goldman Sachs' Chairman and Chief Executive Officer. "Goldman Sachs believes that wind and other renewable forms of energy will become an increasingly important part of the world's energy mix, and Goldman Sachs aspires to play a leading role in this high-growth industry."

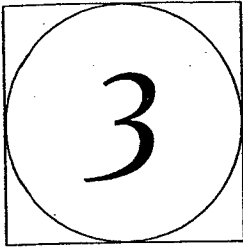
"This acquisition will allow us to leverage Zilkha's strength in wind energy development with Goldman's expertise and market leadership in energy finance and power marketing. Zilkha has established a reputation for excellence in wind energy development. We intend to build upon that reputation and Zilkha's development pipeline to deliver high-quality projects that meet the needs of customers, partners, landowners, and communities," Paulson said.

Michael Zilkha, co-owner and director of Zilkha Renewable Energy, said, "Goldman Sachs's acquisition of Zilkha is a clear sign of wind's emergence as a competitive, efficient, and mainstream energy resource. Because ours is a family-owned company, relationships have always been very important to my father and me. We are maintaining an interest in the new company, and we look forward to a smooth transition to a larger, more integrated enterprise."

"The long-term nature of wind projects places a premium on trust and relationships with customers, suppliers, communities, and landowners. We intend to continue that approach. In doing so, we hope to help accelerate the integration of wind generation into the nation's energy supply," Paulson said.

Goldman Sachs is a leading global investment banking, securities, and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments, and high net worth individuals. Founded in 1869, it is one of the oldest and largest investment banking firms. The firm is headquartered in New York and maintains offices in London, Frankfurt, Tokyo, Hong Kong, and other major financial centers around the world.

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## *LEGAL SHAPING OF DEALS*

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### **A. THE LAW'S DISTINCTIVE ROLES**

Apart from the economic and financial factors discussed in the last chapter that provide incentives for acquisition activity, law frames the choices for those planning deals. The distinctive role of law can be seen in several visible effects on transactions:

- **Providing an efficient form for transactions to realize synergy and other gains from acquisition, as compared to the methods that the parties would have to implement if relegated to contract.** Consider the empowering effects of Delaware §259 entitled "Status, Rights, Liabilities, of Constituent and Surviving or Resulting Corporations Following Merger." Once a merger has occurred, the statute decrees that: "the separate existence of all the constituent corporations . . . shall cease," the new or surviving corporation shall possess "all of the rights, privileges, powers and franchises" of each of the merged corporations, and "all property . . . and all debts" of each of the merged corporations "shall be vested in the corporation surviving." This instantaneous and global transformation of control and legal title, without any additional paperwork other than the filing of the merger documents with a state official, seems almost magical in contrast to the multitudinous bills of sales and various contract documents that would be required to effectively transfer control in the absence of such a statute.
- **Permitting private planners to create separate corporate entities wholly owned by their creator but recognized as separate from their parent.** These separate entities can be used in

acquisitions (and elsewhere) to limit the parent's obligation for liabilities included in or incurred by the subsidiary without the need to separately contract for such protection or draft the terms of such an agreement. This leads, for example, to triangular mergers discussed below or other alternative structuring of acquisition transactions.

- **Protecting various constituencies or the government as a whole by regulatory requirements that an acquisition must satisfy.** For example, state corporations law puts all corporate powers in the hands of the board of directors (*see* Delaware §141) but then empowers shareholders to elect those directors and requires their consent for a merger to take place. Federal securities law seeks to protect the exercise of the shareholder franchise by requiring substantial disclosure to shareholders who are asked to make such decisions. Federal antitrust law provides a means to block transactions that could harm consumers by leading to monopoly or similar market constraints. Government likewise retains the power to specify when transactions require tax payments or otherwise dictates the tax treatment resulting from an acquisition.

Acquisitions can trigger a host of legal and regulatory issues that go well beyond the capacity of this or any single law school course. Our focus here is on four principal sources of law: Corporate law, securities regulation, antitrust, and tax where significant issues are likely to arise in most acquisitions, and even here the greatest focus is on corporate law. Each of those topics often occupies a separate course (or more) in law school, and the discussion here, at least for the last three in this book, is admittedly cursory, flagging issues for later pursuit by one entering the transactional world.

## **B. MERGERS AND OTHER ACQUISITIONS AS A DECISION GOVERNED BY LAW**

### **1. *Corporate Law Reduced to Three (Overly Simplified) Rules***

Corporate law is the source of the "creation" function described above. More centrally for our discussion, it names the corporate players; indeed, only three types of participants are provided for in corporate statutes: shareholders, directors, and officers. For mergers, corporate law specifies who is the "decider" for decisions like mergers and as we will see, sometimes provides exit rights for shareholders from the corporation itself. While it is dangerous, if not foolhardy, to telescope your learning from a prior

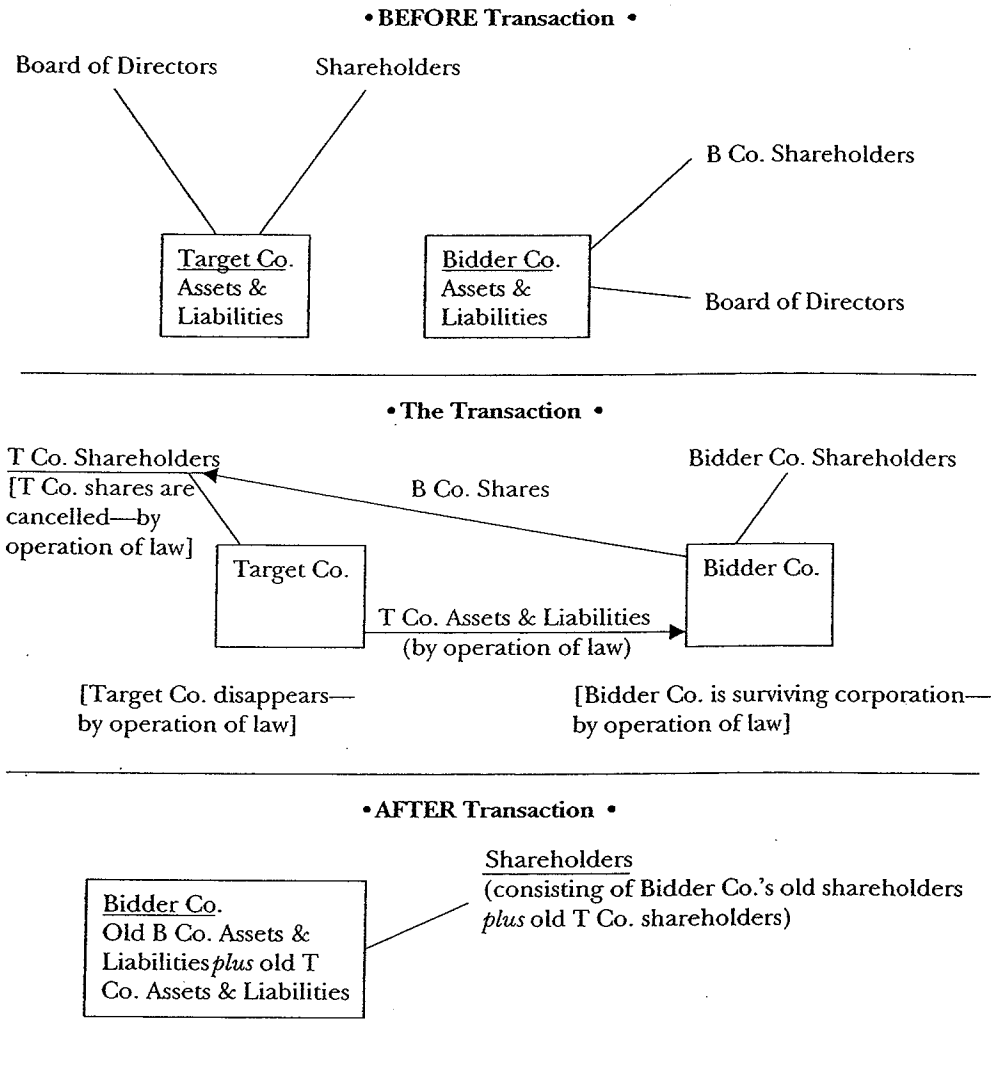
corporations or business associations course into such a capsulated form, let's begin the discussion with three broad, overly simplified points that you might remember from your prior study and which provide a jumping-off point for a more detailed discussion of corporate law in the merger context in the chapters that follow.

- **Rule #1. Directors rule (most of the time).** This principle derives from a bedrock point of corporate law found in all American corporate statutes. *See* Del. §141, MBCA §8.01(b). The power given to the board includes product decisions, hiring and firing employees and making compensation contracts with them, buying and selling assets in the ordinary course of business, and issuing shares and other securities (provided they have been authorized in the corporation's articles of incorporation). In other words, directors (and the officers they are authorized to appoint) get to do most everything. The business judgment rule, a presumption of judicial deference to director decisions discussed in more detail in Chapter 5, reflects this same principle. Empowering a centralized group to speak for the entity provides efficiency benefits in an economy where shareholding is widely dispersed. As a centralized decision-maker, directors can negotiate on behalf of shareholders and other constituencies. At the same time, directors with this broad power to direct other people's money might not pay the attention to this effort that the shareholders would like them to pay or may use their power to benefit themselves or the managers who they fail to monitor sufficiently. This leads to Rules 2 and 3 below. Mergers, sale of substantially all of the entity's assets, and charter amendments are partial exceptions to this rule in that they may require a shareholder vote after board approval, as discussed below.
- **Rule #2. Shareholders check directors, but only in three limited ways—vote, sell, and sue.** Shareholders are not given plenary powers to decide corporate policy. Rather, they are conceived as simple creatures who, like babies, exercise three basic functions. First, they are permitted to elect directors once a year (with additional limitations that we consider in more detail in later chapters) and vote on mergers and other fundamental changes, once the directors have decided they want to put such a matter to the shareholders. Shareholder power to amend the corporation's bylaws in some situations without the board playing a gate-keeping role has taken on broader importance in takeovers in recent years. Second, shareholders can sell their shares, either in the market or in response to a tender offer made to them by a bidder seeking to acquire control. Third, they can bring suit as part of the judicial function described below. This power given to shareholders reflects the concern that directors, while providing the advantages of

centralized control, may, if unconstrained, act in ways that benefit themselves or otherwise harm shareholders. Shareholders, so the argument goes, are best positioned as the residual claimant of the enterprise to perform this monitoring function.

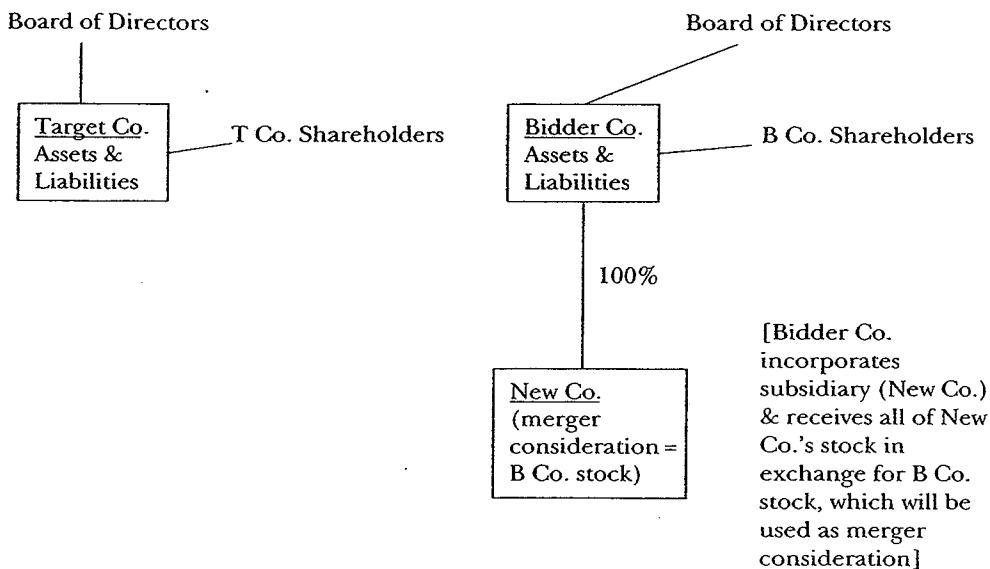
- **Rule #3. Judicial review to check agency power via fiduciary duties.** American corporate law relies on courts to constrain director decisions (and possible abuse of their centralized power) by enforcing fiduciary duties of care and loyalty. Much of our specific focus in later chapters focuses on how intrusive is judicial review in the takeover setting, ranging from a deferential business judgment standard to the much more intrusive “entire fairness” review, with the intermediate standards of *Unocal* and *Revlon* occupying space between the other two.

**DIAGRAM 1**  
**Traditional Form of Stock for Stock Direct (Statutory) Merger**

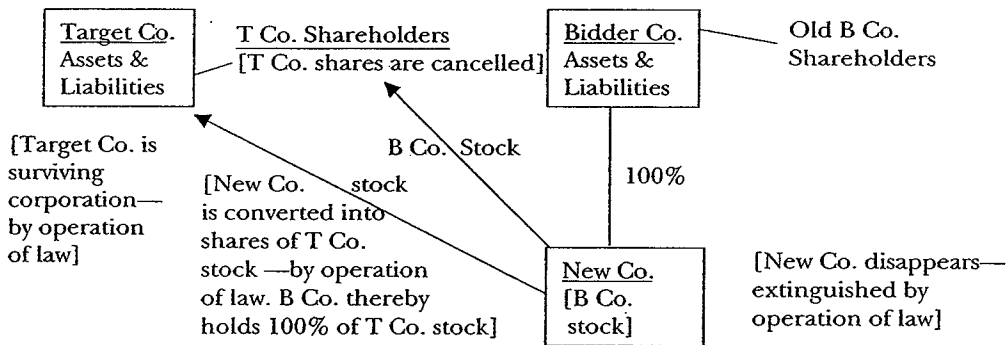


**DIAGRAM 10**  
**Reverse Triangular Merger**  
**(Using Stock as Merger Consideration)**

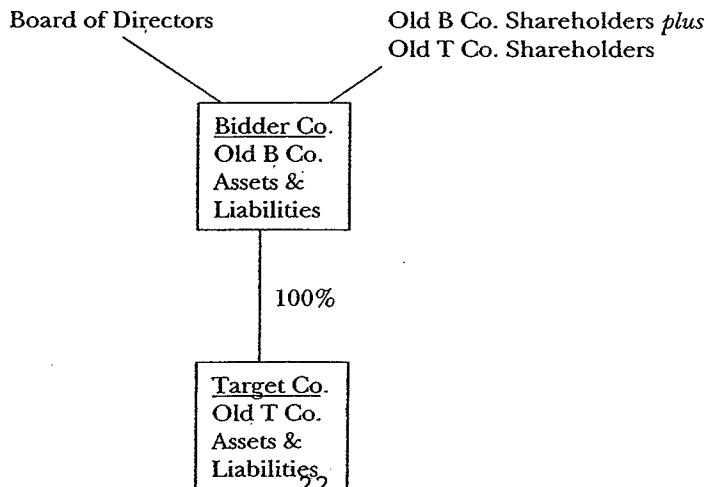
•BEFORE Transaction •



•In the Transaction •  
 (New Co. Merges into Target Co.)

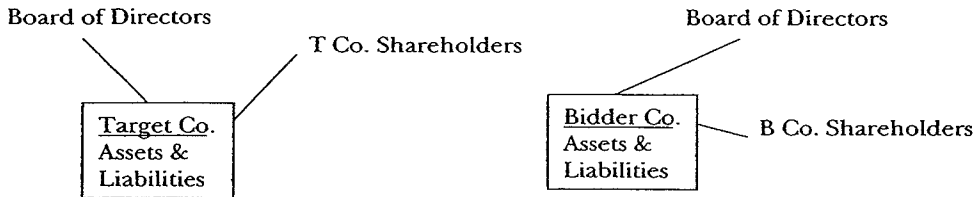


•AFTER the Transaction •

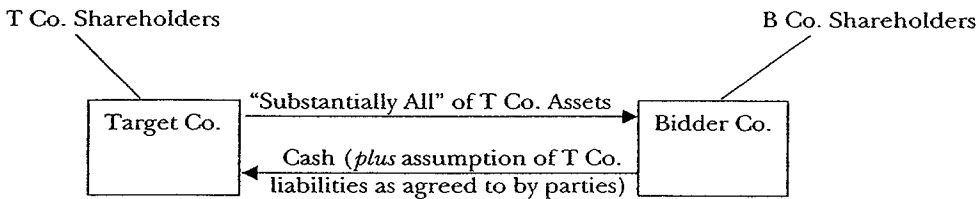


**DIAGRAM 4**  
**Traditional Form of Asset Purchase:**  
**Sale of Substantially All of Target Co. Assets for Cash — Followed by Dissolution**  
**of Target Co.**

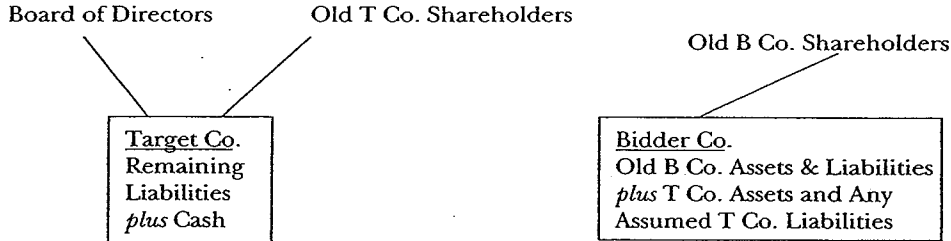
• BEFORE Transaction •



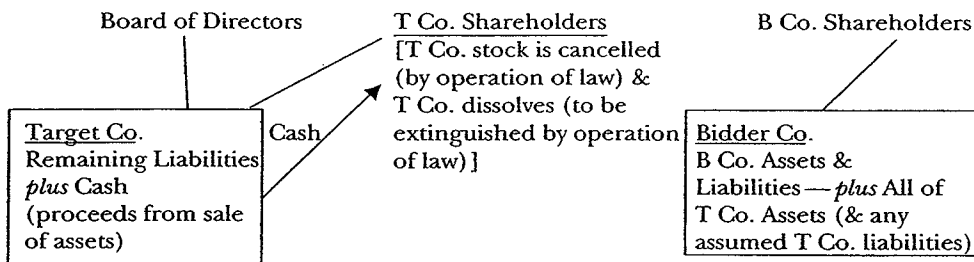
• FIRST Step: Sale of Target Co. Assets to Bidder Co. •



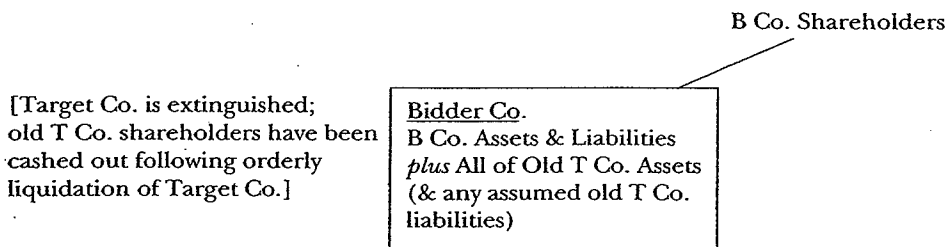
• AFTER Sale of Substantially All of Target Co. Assets •



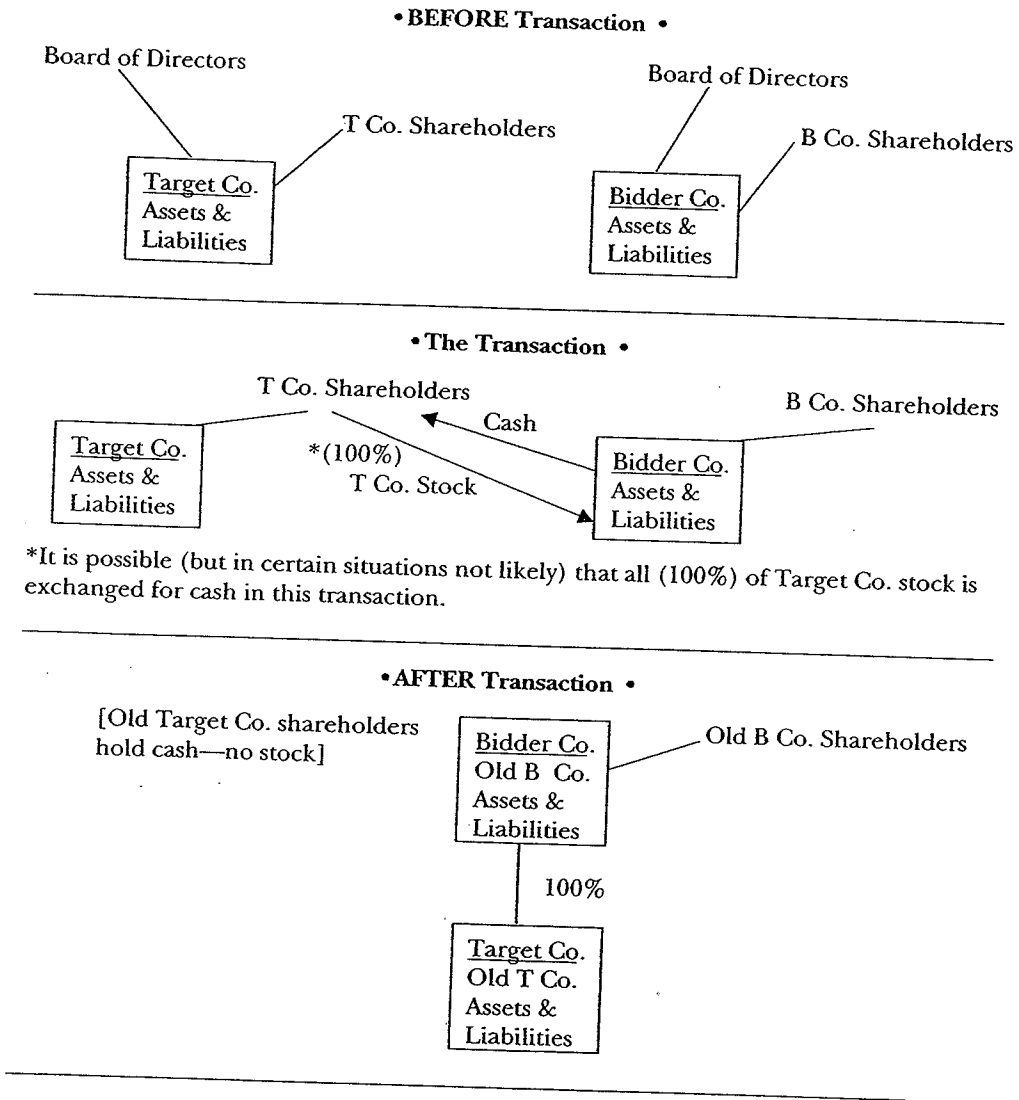
• SECOND Step: Dissolution of Target Co. •



• AFTER Second Step Dissolution •



**DIAGRAM 6**  
**Traditional Form of Stock Purchase for Cash**



**EXCERPTS FROM GENERAL CORPORATION LAW  
OF THE STATE OF DELAWARE**

**§ 251. Merger or consolidation of domestic corporations.**

(a) Any 2 or more corporations existing under the laws of this State may merge into a single corporation, which may be any 1 of the constituent corporations or may consolidate into a new corporation formed by the consolidation, pursuant to an agreement of merger or consolidation, as the case may be, complying and approved in accordance with this section.

(b) The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation and declaring its advisability. The agreement shall state: (1) The terms and conditions of the merger or consolidation; (2) the mode of carrying the same into effect; (3) in the case of a merger, such amendments or changes in the certificate of incorporation of the surviving corporation as are desired to be effected by the merger, or, if no such amendments or changes are desired, a statement that the certificate of incorporation of the surviving corporation shall be its certificate of incorporation; (4) in the case of a consolidation, that the certificate of incorporation of the resulting corporation shall be as is set forth in an attachment to the agreement; (5) the manner, if any, of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation, or of cancelling some or all of such shares, and, if any shares of any of the constituent corporations are not to remain outstanding, to be converted solely into shares or other securities of the surviving or resulting corporation or to be cancelled, the cash, property, rights or securities of any other corporation or entity which the holders of such shares are to receive in exchange for, or upon conversion of such shares and the surrender of any certificates evidencing them, which cash, property, rights or securities of any other corporation or entity may be in addition to or in lieu of shares or other securities of the surviving or resulting corporation; and (6) such other details or provisions as are deemed desirable, including, without limiting the generality of the foregoing, a provision for the payment of cash in lieu of the issuance or recognition of fractional shares, interests or rights, or for any other arrangement with respect thereto, consistent with § 155 of this title. The agreement so adopted shall be executed and acknowledged in accordance with § 103 of this title. Any of the terms of the agreement of merger or consolidation may be made dependent upon facts ascertainable outside of such agreement, provided that the manner in which such facts shall operate upon the terms of the agreement is clearly and expressly set forth in the agreement of merger or consolidation. The term "facts," as used in the preceding sentence, includes, but is not limited to, the occurrence of any event, including a determination or action by any person or body, including the corporation.

(c) The agreement required by subsection (b) of this section shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement. Due notice of the time, place and purpose of the

meeting shall be mailed to each holder of stock, whether voting or nonvoting, of the corporation at the stockholder's address as it appears on the records of the corporation, at least 20 days prior to the date of the meeting. The notice shall contain a copy of the agreement or a brief summary thereof, as the directors shall deem advisable. At the meeting, the agreement shall be considered and a vote taken for its adoption or rejection. If a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the agreement, that fact shall be certified on the agreement by the secretary or assistant secretary of the corporation, provided that such certification on the agreement shall not be required if a certificate of merger or consolidation is filed in lieu of filing the agreement. If the agreement shall be so adopted and certified by each constituent corporation, it shall then be filed and shall become effective, in accordance with § 103 of this title. In lieu of filing the agreement of merger or consolidation required by this section, the surviving or resulting corporation may file a certificate of merger or consolidation, executed in accordance with § 103 of this title, which states:

- (1) The name and state of incorporation of each of the constituent corporations;
- (2) That an agreement of merger or consolidation has been approved, adopted, executed and acknowledged by each of the constituent corporations in accordance with this section;
- (3) The name of the surviving or resulting corporation;
- (4) In the case of a merger, such amendments or changes in the certificate of incorporation of the surviving corporation as are desired to be effected by the merger, or, if no such amendments or changes are desired, a statement that the certificate of incorporation of the surviving corporation shall be its certificate of incorporation;
- (5) In the case of a consolidation, that the certificate of incorporation of the resulting corporation shall be as set forth in an attachment to the certificate;
- (6) That the executed agreement of consolidation or merger is on file at an office of the surviving corporation, stating the address thereof; and
- (7) That a copy of the agreement of consolidation or merger will be furnished by the surviving corporation, on request and without cost, to any stockholder of any constituent corporation.

(d) Any agreement of merger or consolidation may contain a provision that at any time prior to the time that the agreement (or a certificate in lieu thereof) filed with the Secretary of State becomes effective in accordance with § 103 of this title, the agreement may be terminated by the board of directors of any constituent corporation notwithstanding approval of the agreement by the stockholders of all or any of the constituent corporations; in the event the agreement of merger or consolidation is terminated after the filing of the agreement (or a certificate in lieu thereof) with the Secretary of State but before the agreement (or a certificate in lieu thereof) has become

effective, a certificate of termination or merger or consolidation shall be filed in accordance with § 103 of this title. Any agreement of merger or consolidation may contain a provision that the boards of directors of the constituent corporations may amend the agreement at any time prior to the time that the agreement (or a certificate in lieu thereof) filed with the Secretary of State becomes effective in accordance with § 103 of this title, provided that an amendment made subsequent to the adoption of the agreement by the stockholders of any constituent corporation shall not (1) alter or change the amount or kind of shares, securities, cash, property and/or rights to be received in exchange for or on conversion of all or any of the shares of any class or series thereof of such constituent corporation, (2) alter or change any term of the certificate of incorporation of the surviving corporation to be effected by the merger or consolidation, or (3) alter or change any of the terms and conditions of the agreement if such alteration or change would adversely affect the holders of any class or series thereof of such constituent corporation; in the event the agreement of merger or consolidation is amended after the filing thereof with the Secretary of State but before the agreement has become effective, a certificate of amendment of merger or consolidation shall be filed in accordance with § 103 of this title.

(e) In the case of a merger, the certificate of incorporation of the surviving corporation shall automatically be amended to the extent, if any, that changes in the certificate of incorporation are set forth in the agreement of merger.

(f) Notwithstanding the requirements of subsection (c) of this section, unless required by its certificate of incorporation, no vote of stockholders of a constituent corporation surviving a merger shall be necessary to authorize a merger if (1) the agreement of merger does not amend in any respect the certificate of incorporation of such constituent corporation, (2) each share of stock of such constituent corporation outstanding immediately prior to the effective date of the merger is to be an identical outstanding or treasury share of the surviving corporation after the effective date of the merger, and (3) either no shares of common stock of the surviving corporation and no shares, securities or obligations convertible into such stock are to be issued or delivered under the plan of merger, or the authorized unissued shares or the treasury shares of common stock of the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed 20% of the shares of common stock of such constituent corporation outstanding immediately prior to the effective date of the merger. No vote of stockholders of a constituent corporation shall be necessary to authorize a merger or consolidation if no shares of the stock of such corporation shall have been issued prior to the adoption by the board of directors of the resolution approving the agreement of merger or consolidation. If an agreement of merger is adopted by the constituent corporation surviving the merger, by action of its board of directors and without any vote of its stockholders pursuant to this subsection, the secretary or assistant secretary of that corporation shall certify on the agreement that the agreement has been adopted pursuant to this subsection and, (1) if it has been adopted pursuant to the first sentence of this subsection, that the conditions specified in that sentence have been satisfied, or (2) if it has been adopted pursuant to the second

sentence of this subsection, that no shares of stock of such corporation were issued prior to the adoption by the board of directors of the resolution approving the agreement of merger or consolidation, provided that such certification on the agreement shall not be required if a certificate of merger or consolidation is filed in lieu of filing the agreement. The agreement so adopted and certified shall then be filed and shall become effective, in accordance with § 103 of this title. Such filing shall constitute a representation by the person who executes the agreement that the facts stated in the certificate remain true immediately prior to such filing.

(g) Notwithstanding the requirements of subsection (c) of this section, unless expressly required by its certificate of incorporation, no vote of stockholders of a constituent corporation shall be necessary to authorize a merger with or into a single direct or indirect wholly-owned subsidiary of such constituent corporation if: (1) such constituent corporation and the direct or indirect wholly-owned subsidiary of such constituent corporation are the only constituent entities to the merger; (2) each share or fraction of a share of the capital stock of the constituent corporation outstanding immediately prior to the effective time of the merger is converted in the merger into a share or equal fraction of share of capital stock of a holding company having the same designations, rights, powers and preferences, and the qualifications, limitations and restrictions thereof, as the share of stock of the constituent corporation being converted in the merger; (3) the holding company and the constituent corporation are corporations of this State and the direct or indirect wholly-owned subsidiary that is the other constituent entity to the merger is a corporation or limited liability company of this State; (4) the certificate of incorporation and by-laws of the holding company immediately following the effective time of the merger contain provisions identical to the certificate of incorporation and by-laws of the constituent corporation immediately prior to the effective time of the merger (other than provisions, if any, regarding the incorporator or incorporators, the corporate name, the registered office and agent, the initial board of directors and the initial subscribers for shares and such provisions contained in any amendment to the certificate of incorporation as were necessary to effect a change, exchange, reclassification, subdivision, combination or cancellation of stock, if such change, exchange, reclassification, subdivision, combination, or cancellation has become effective); (5) as a result of the merger the constituent corporation or its successor becomes or remains a direct or indirect wholly-owned subsidiary of the holding company; (6) the directors of the constituent corporation become or remain the directors of the holding company upon the effective time of the merger; (7) the organizational documents of the surviving entity immediately following the effective time of the merger contain provisions identical to the certificate of incorporation of the constituent corporation immediately prior to the effective time of the merger (other than provisions, if any, regarding the incorporator or incorporators, the corporate or entity name, the registered office and agent, the initial board of directors and the initial subscribers for shares, references to members rather than stockholders or shareholders, references to interests, units or the like rather than stock or shares, references to managers, managing members or other members of the governing body rather than directors and such provisions contained in any amendment to the certificate of incorporation as were necessary to effect a change, exchange, reclassification,

subdivision, combination or cancellation of stock, if such change, exchange, reclassification, subdivision, combination or cancellation has become effective); provided, however, that (i) if the organizational documents of the surviving entity do not contain the following provisions, they shall be amended in the merger to contain provisions requiring that (A) any act or transaction by or involving the surviving entity, other than the election or removal of directors or managers, managing members or other members of the governing body of the surviving entity, that requires for its adoption under this chapter or its organizational documents the approval of the stockholders or members of the surviving entity shall, by specific reference to this subsection, require, in addition, the approval of the stockholders of the holding company (or any successor by merger), by the same vote as is required by this chapter and/or by the organizational documents of the surviving entity; provided, however, that for purposes of this clause (i)(A), any surviving entity that is not a corporation shall include in such amendment a requirement that the approval of the stockholders of the holding company be obtained for any act or transaction by or involving the surviving entity, other than the election or removal of directors or managers, managing members or other members of the governing body of the surviving entity, which would require the approval of the stockholders of the surviving entity if the surviving entity were a corporation subject to this chapter; (B) any amendment of the organizational documents of a surviving entity that is not a corporation, which amendment would, if adopted by a corporation subject to this chapter, be required to be included in the certificate of incorporation of such corporation, shall, by specific reference to this subsection, require, in addition, the approval of the stockholders of the holding company (or any successor by merger), by the same vote as is required by this chapter and/or by the organizational documents of the surviving entity; and (C) the business and affairs of a surviving entity that is not a corporation shall be managed by or under the direction of a board of directors, board of managers or other governing body consisting of individuals who are subject to the same fiduciary duties applicable to, and who are liable for breach of such duties to the same extent as, directors of a corporation subject to this chapter; and (ii) the organizational documents of the surviving entity may be amended in the merger (A) to reduce the number of classes and shares of capital stock or other equity interests or units that the surviving entity is authorized to issue and (B) to eliminate any provision authorized by subsection (d) of § 141 of this title; and (8) the stockholders of the constituent corporation do not recognize gain or loss for United States federal income tax purposes as determined by the board of directors of the constituent corporation. Neither paragraph (g)(7)(i) of this section nor any provision of a surviving entity's organizational documents required by paragraph (g)(7)(i) of this section shall be deemed or construed to require approval of the stockholders of the holding company to elect or remove directors or managers, managing members or other members of the governing body of the surviving entity. The term "organizational documents", as used in paragraph (g)(7) of this section and in the preceding sentence, shall, when used in reference to a corporation, mean the certificate of incorporation of such corporation, and when used in reference to a limited liability company, mean the limited liability company agreement of such limited liability company.

As used in this subsection only, the term "holding company" means a corporation which, from its incorporation until consummation of a merger governed by this subsection, was at all times a direct or indirect wholly-owned subsidiary of the constituent corporation and whose capital stock is issued in such merger. From and after the effective time of a merger adopted by a constituent corporation by action of its board of directors and without any vote of stockholders pursuant to this subsection: (i) to the extent the restrictions of § 203 of this title applied to the constituent corporation and its stockholders at the effective time of the merger, such restrictions shall apply to the holding company and its stockholders immediately after the effective time of the merger as though it were the constituent corporation, and all shares of stock of the holding company acquired in the merger shall for purposes of § 203 of this title be deemed to have been acquired at the time that the shares of stock of the constituent corporation converted in the merger were acquired, and provided further that any stockholder who immediately prior to the effective time of the merger was not an interested stockholder within the meaning of § 203 of this title shall not solely by reason of the merger become an interested stockholder of the holding company, (ii) if the corporate name of the holding company immediately following the effective time of the merger is the same as the corporate name of the constituent corporation immediately prior to the effective time of the merger, the shares of capital stock of the holding company into which the shares of capital stock of the constituent corporation are converted in the merger shall be represented by the stock certificates that previously represented shares of capital stock of the constituent corporation and (iii) to the extent a stockholder of the constituent corporation immediately prior to the merger had standing to institute or maintain derivative litigation on behalf of the constituent corporation, nothing in this section shall be deemed to limit or extinguish such standing. If an agreement of merger is adopted by a constituent corporation by action of its board of directors and without any vote of stockholders pursuant to this subsection, the secretary or assistant secretary of the constituent corporation shall certify on the agreement that the agreement has been adopted pursuant to this subsection and that the conditions specified in the first sentence of this subsection have been satisfied, provided that such certification on the agreement shall not be required if a certificate of merger or consolidation is filed in lieu of filing the agreement. The agreement so adopted and certified shall then be filed and become effective, in accordance with § 103 of this title. Such filing shall constitute a representation by the person who executes the agreement that the facts stated in the certificate remain true immediately prior to such filing.

**§ 259. Status, rights, liabilities, of constituent and surviving or resulting corporations following merger or consolidation.**

(a) When any merger or consolidation shall have become effective under this chapter, for all purposes of the laws of this State the separate existence of all the constituent corporations, or of all such constituent corporations except the one into which the other or others of such constituent corporations have been merged, as the case may be, shall cease and the constituent corporations shall become a new corporation, or be merged into 1 of such corporations, as the case may be, possessing all the rights, privileges, powers and franchises as well of a public as of a private nature, and being subject to all

the restrictions, disabilities and duties of each of such corporations so merged or consolidated; and all and singular, the rights, privileges, powers and franchises of each of said corporations, and all property, real, personal and mixed, and all debts due to any of said constituent corporations on whatever account, as well for stock subscriptions as all other things in action or belonging to each of such corporations shall be vested in the corporation surviving or resulting from such merger or consolidation; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation as they were of the several and respective constituent corporations, and the title to any real estate vested by deed or otherwise, under the laws of this State, in any of such constituent corporations, shall not revert or be in any way impaired by reason of this chapter; but all rights of creditors and all liens upon any property of any of said constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said surviving or resulting corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

(b) In the case of a merger of banks or trust companies, without any order or action on the part of any court or otherwise, all appointments, designations, and nominations, and all other rights and interests as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, trustee of estates of persons mentally ill and in every other fiduciary capacity, shall be automatically vested in the corporation resulting from or surviving such merger; provided, however, that any party in interest shall have the right to apply to an appropriate court or tribunal for a determination as to whether the surviving corporation shall continue to serve in the same fiduciary capacity as the merged corporation, or whether a new and different fiduciary should be appointed.

## **§ 262. Appraisal rights.**

(a) Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation, who has otherwise complied with subsection (d) of this section and who has neither voted in favor of the merger or consolidation nor consented thereto in writing pursuant to § 228 of this title shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock under the circumstances described in subsections (b) and (c) of this section. As used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a nonstock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a nonstock corporation; and the words "depository receipt" mean a receipt or other instrument issued by a depository representing an interest in one or more shares, or fractions thereof, solely of stock of a corporation, which stock is deposited with the depository.

(b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to § 251 (other than a merger effected pursuant to § 251(g) of this title), § 252, § 254, § 257, § 258, § 263 or § 264 of this title:

(1) Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock, which stock, or depository receipts in respect thereof, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (i) listed on a national securities exchange or (ii) held of record by more than 2,000 holders; and further provided that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this title.

(2) Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to §§ 251, 252, 254, 257, 258, 263 and 264 of this title to accept for such stock anything except:

a. Shares of stock of the corporation surviving or resulting from such merger or consolidation, or depository receipts in respect thereof;

b. Shares of stock of any other corporation, or depository receipts in respect thereof, which shares of stock (or depository receipts in respect thereof) or depository receipts at the effective date of the merger or consolidation will be either listed on a national securities exchange or held of record by more than 2,000 holders;

c. Cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a. and b. of this paragraph; or

d. Any combination of the shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a., b. and c. of this paragraph.

(3) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation.

(c) Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation

contains such a provision, the procedures of this section, including those set forth in subsections (d) and (e) of this section, shall apply as nearly as is practicable.

(d) Appraisal rights shall be perfected as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders who was such on the record date for such meeting with respect to shares for which appraisal rights are available pursuant to subsection (b) or (c) hereof that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. Each stockholder electing to demand the appraisal of such stockholder's shares shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of such stockholder's shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such stockholder's shares. A proxy or vote against the merger or consolidation shall not constitute such a demand. A stockholder electing to take such action must do so by a separate written demand as herein provided. Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective; or

(2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this title, then either a constituent corporation before the effective date of the merger or consolidation or the surviving or resulting corporation within 10 days thereafter shall notify each of the holders of any class or series of stock of such constituent corporation who are entitled to appraisal rights of the approval of the merger or consolidation and that appraisal rights are available for any or all shares of such class or series of stock of such constituent corporation, and shall include in such notice a copy of this section. Such notice may, and, if given on or after the effective date of the merger or consolidation, shall, also notify such stockholders of the effective date of the merger or consolidation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of such notice, demand in writing from the surviving or resulting corporation the appraisal of such holder's shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such holder's shares. If such notice did not notify stockholders of the effective date of the merger or consolidation, either (i) each such constituent corporation shall send a second notice before the effective date of the merger or consolidation notifying each of the holders of any class or series of stock of such constituent corporation that are entitled to appraisal rights of the effective date of the merger or consolidation or (ii) the surviving or resulting corporation shall send such a second notice to all such holders on or within 10 days after such effective date; provided, however, that if such second notice is sent more than 20 days following the sending of the first notice, such second notice need only be sent to each stockholder who is entitled

to appraisal rights and who has demanded appraisal of such holder's shares in accordance with this subsection. An affidavit of the secretary or assistant secretary or of the transfer agent of the corporation that is required to give either notice that such notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated therein. For purposes of determining the stockholders entitled to receive either notice, each constituent corporation may fix, in advance, a record date that shall be not more than 10 days prior to the date the notice is given, provided, that if the notice is given on or after the effective date of the merger or consolidation, the record date shall be such effective date. If no record date is fixed and the notice is given prior to the effective date, the record date shall be the close of business on the day next preceding the day on which the notice is given.

(e) Within 120 days after the effective date of the merger or consolidation, the surviving or resulting corporation or any stockholder who has complied with subsections (a) and (d) of this section hereof and who is otherwise entitled to appraisal rights, may commence an appraisal proceeding by filing a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any time within 60 days after the effective date of the merger or consolidation, any stockholder who has not commenced an appraisal proceeding or joined that proceeding as a named party shall have the right to withdraw such stockholder's demand for appraisal and to accept the terms offered upon the merger or consolidation. Within 120 days after the effective date of the merger or consolidation, any stockholder who has complied with the requirements of subsections (a) and (d) of this section hereof, upon written request, shall be entitled to receive from the corporation surviving the merger or resulting from the consolidation a statement setting forth the aggregate number of shares not voted in favor of the merger or consolidation and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. Such written statement shall be mailed to the stockholder within 10 days after such stockholder's written request for such a statement is received by the surviving or resulting corporation or within 10 days after expiration of the period for delivery of demands for appraisal under subsection (d) of this section hereof, whichever is later. Notwithstanding subsection (a) of this section, a person who is the beneficial owner of shares of such stock held either in a voting trust or by a nominee on behalf of such person may, in such person's own name, file a petition or request from the corporation the statement described in this subsection.

(f) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the surviving or resulting corporation, which shall within 20 days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the surviving or resulting corporation. If the petition shall be filed by the surviving or resulting corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery, if so ordered by the Court, shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the surviving or resulting corporation and to the stockholders shown on

the list at the addresses therein stated. Such notice shall also be given by 1 or more publications at least 1 week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware or such publication as the Court deems advisable. The forms of the notices by mail and by publication shall be approved by the Court, and the costs thereof shall be borne by the surviving or resulting corporation.

(g) At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder.

(h) After the Court determines the stockholders entitled to an appraisal, the appraisal proceeding shall be conducted in accordance with the rules of the Court of Chancery, including any rules specifically governing appraisal proceedings. Through such proceeding the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors. Unless the Court in its discretion determines otherwise for good cause shown, interest from the effective date of the merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment. Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, proceed to trial upon the appraisal prior to the final determination of the stockholders entitled to an appraisal. Any stockholder whose name appears on the list filed by the surviving or resulting corporation pursuant to subsection (f) of this section and who has submitted such stockholder's certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until it is finally determined that such stockholder is not entitled to appraisal rights under this section.

(i) The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Payment shall be so made to each such stockholder, in the case of holders of uncertificated stock forthwith, and the case of holders of shares represented by certificates upon the surrender to the corporation of the certificates representing such stock. The Court's decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any state.

(j) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon application of a stockholder, the Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rata against the value of all the shares entitled to an appraisal.

(k) From and after the effective date of the merger or consolidation, no stockholder who has demanded appraisal rights as provided in subsection (d) of this section shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (e) of this section, or if such stockholder shall deliver to the surviving or resulting corporation a written withdrawal of such stockholder's demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (e) of this section or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just; provided, however that this provision shall not affect the right of any stockholder who has not commenced an appraisal proceeding or joined that proceeding as a named party to withdraw such stockholder's demand for appraisal and to accept the terms offered upon the merger or consolidation within 60 days after the effective date of the merger or consolidation, as set forth in subsection (e) of this section.

(l) The shares of the surviving or resulting corporation to which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

#### **§ 271. Sale, lease or exchange of assets; consideration; procedure.**

(a) Every corporation may at any meeting of its board of directors or governing body sell, lease or exchange all or substantially all of its property and assets, including its goodwill and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations, as its board of directors or governing body deems expedient and for the best interests of the corporation, when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon or, if the corporation is a nonstock corporation, by a majority of the members having the right to vote for the election of the members of the governing body, at a meeting duly

called upon at least 20 days' notice. The notice of the meeting shall state that such a resolution will be considered.

(b) Notwithstanding authorization or consent to a proposed sale, lease or exchange of a corporation's property and assets by the stockholders or members, the board of directors or governing body may abandon such proposed sale, lease or exchange without further action by the stockholders or members, subject to the rights, if any, of third parties under any contract relating thereto.

(c) For purposes of this section only, the property and assets of the corporation include the property and assets of any subsidiary of the corporation. As used in this subsection, "subsidiary" means any entity wholly-owned and controlled, directly or indirectly, by the corporation and includes, without limitation, corporations, partnerships, limited partnerships, limited liability partnerships, limited liability companies, and/or statutory trusts. Notwithstanding subsection (a) of this section, except to the extent the certificate of incorporation otherwise provides, no resolution by stockholders or members shall be required for a sale, lease or exchange of property and assets of the corporation to a subsidiary.

## ***D. "Deal Flow": Conceptualizing the Deal Process***

### **1. The Start of Negotiations**

Deals get started in a variety of different ways. Acquisitions often get started because a financial advisor, frequently an investment banking firm, will identify a particular business as a potential acquisition candidate. The potential acquisition candidate may be a client of the investment banking firm, who has retained this financial advisor to help the corporate client find a buyer for the company's business. Alternatively, the investment banker may be scouting for potential acquisition candidates for one of its established corporate clients, either at the request of its client or, alternatively, as part of the banker's ongoing professional relationship with that particular corporate client. Yet another way for a deal to get launched is for the Bidder's existing management to contact management of a company that the Bidder itself has identified as a potential acquisition target based on its own internal assessment of the industry and the Bidder's business goals and objectives. In cases where existing management identifies the potential acquisition target, early discussions between Bidder and Target may initially proceed without the assistance of outside advisors. Eventually, though, financial and legal advisors will get involved in the deal-making process.

### **2. The Role of Financial Advisors**

As negotiations are launched in earnest, the assistance of financial and legal advisors becomes important in addressing two issues that are common to all acquisitions: how should the deal be structured and how much will the Bidder

pay to acquire Target. In Chapter 2, we will analyze the different types of deal structures available to complete the acquisition. As we shall see, the legal rules that must be satisfied for each type of deal structure will often influence the decision as to which type of structure is most appropriate for a particular deal. In addition, financial advisors will be assisting Bidder in its decision as to how much to pay to acquire Target, which necessarily requires Bidder to value Target's business. On the other side, Target will engage its own set of financial advisors to help it determine whether Bidder is offering a fair price to acquire Target's business. Since Target only gets one chance to sell its business and relinquish control over its income-producing operations, Target has a strong vested interest in making sure that it obtains the best price available. Although Target's management may have a strong sense of what it thinks its business is worth, there are other variables that influence the price that it can obtain for its business. Not the least of which is the general condition of the market at the time of sale as well as the general business environment within Target's specific industry. These variables, and the financial well being of Target's own business, will heavily influence the bargaining process between Bidder and Target as to the purchase price.

Even though Target may have strong convictions as to the true value of its business, there are many variables to be juggled in reaching a consensus with Bidder as to the purchase price. In dealing with the confluence of all these variables in the context of a particular deal, most buyers and sellers—regardless of the size of the deal—understand the need to bring in the expertise of outside advisors. All of which illustrates the fundamental truism that valuation is an art, not a science. And, just as beauty is in the eye of the beholder, judgments as to valuation can vary widely between buyers and sellers. Outside advisors can often provide the experience and expertise that will result in closing the gap between Bidder and Target, thereby facilitating the ability of the parties to reach an agreement as to the terms of the acquisition purchase price and the nature of the consideration to be paid. As part of these negotiations, Bidder may require that Target share information about its business and financial affairs so that Bidder can more accurately determine what it is willing to pay to acquire Target.

*Use of confidentiality agreements.* This exchange of information between Bidder and Target may require the parties to share with each other highly sensitive, confidential, and proprietary information about their businesses. Obviously, each side will be concerned about maintaining the confidentiality of this information. This concern usually will lead to the use of confidentiality agreements to protect against misuse of the business and financial information that Bidder and Target will exchange with each other. Accordingly, early in the deal process, the parties will usually enter into a confidentiality agreement (commonly referred to as a non-disclose agreement or "NDA") to assure each other that confidential and proprietary business information shared during the acquisition process will be carefully protected and not used for any purpose other than evaluating the proposed transaction. We will discuss the use of NDAs in detail in Chapter 5.

*Who are the deal players?* In mega-deals, such as Pfizer's acquisition of Pharmacia, each side will generally rely on its own Wall Street investment

banker, such as the well known firms of Goldman Sachs, Bear Stearns & Co., or Merrill Lynch. In smaller deals involving closely held companies, mid-size investment bankers may get involved, firms whose names are not as well known. And, in even smaller deals involving the sale of closely held, often family-owned businesses, no investment banker is used. Instead the company is listed for sale with a business broker, much in the same way that homeowners list their homes for sale with a real estate broker, who will typically receive a commission when the deal closes. Likewise, the financial advisor will receive a fee for its services as a business broker, which is often framed in terms of a commission to be paid when the deal between Bidder and Target closes.

### 3. Use of Non-Cash Consideration to Finance the Purchase Price

Often Bidder will seek to acquire Target for non-cash consideration. As we will see when we analyze the diagrams in Appendix A, this will result in a very different treatment of Target Co.'s shareholders after the acquisition is completed. Where Bidder issues its stock in exchange for Target's business, Target Co. shareholders will end up owning Bidder Co. stock. This presents a very different investment decision for Target's shareholders. Now they must decide whether they want to invest in Bidder Co., which means that Target Co. shareholders face a separate and often rather complicated valuation decision of their own. In addition to deciding the amount for which they are willing to sell Target's business, Target's shareholders now must also determine what value they place on Bidder's business on a going forward basis. This decision usually will require Bidder to provide to Target's shareholders information about Bidder's business and its plans for the future after acquiring Target's business.

### 4. The Due Diligence Process

*Due diligence* is a term of art used to describe the process of information gathering and analysis, which will usually be undertaken by each party to the business acquisition. The focus is on gathering all relevant information necessary to a thorough evaluation of the other company's business and financial affairs. From the perspective of Bidder, the goal of its due diligence investigation of Target is to gain all the information it needs — good and bad — to be sure that it does not overpay to acquire Target. From Target's perspective, the scope of its due diligence will depend in large part on the nature of the acquisition consideration offered by the Bidder. In the case of an all cash deal, Target's primary concern is the adequacy of the price offered. Since Target gets only one chance to sell its business operations, it has a vested interest in making sure that it obtains as big a premium as it can — in other words, the best price it can negotiate. In making this determination, however, Target needs minimal, if any, information about Bidder and its plans for the future since Target shareholders will have no further equity participation in the case of an all-cash purchase price.

On the other hand, if Bidder is offering to acquire Target in exchange for Bidder's stock, Target's due diligence process will be broader in scope. In this situation, Target shareholders need information about Bidder's plans to integrate Target's assets into Bidder's business operations. This information from Bidder Co. will be an important factor in the Target Co. shareholders' decision whether to remain independent and continue as the equity owners of Target Co., or alternatively, to combine with Bidder Co. and rely on Bidder Co.'s leadership and business model to maximize their financial return. We will talk at greater length in Chapter 4 about the process for disseminating this information to Target Co. shareholders and the manner in which the federal securities laws regulate this disclosure process in the case of constituent corporation(s) that is/are publicly traded.

## 5. Board Approval of an Acquisition

In the case of most acquisitions, approval by the board of directors of both Bidder and Target will be required in order for the transaction to proceed. Generally speaking, the acquisition proposal does not originate with the company's board. Rather, the CEO, supported by his or her senior executive officers, initiates the process and is usually responsible for negotiating the terms of the transaction. Ultimately, the deal will be made binding on the company only if the board approves the terms of the negotiated agreement. In our post-Enron world of corporate governance, there is an interesting tension at work, which has always been present but which has been receiving increased attention in light of the recent spate of financial scandals. This tension derives from the fundamental tenet that the board manages the business affairs of the company but it is the company's officers, most importantly the company's CEO, who is responsible for implementing these policy decisions as the agents of the corporation. The board members act collectively (generally by way of a duly noticed board meeting) and individually have no authority to bind the corporation. Officers, on the other hand, have authority by virtue of their position to bind the company. So the CEO may enter into contracts that are binding on the company so long as they are in the ordinary course of business and are not extraordinary.

In the case of an acquisition, there is the interesting threshold question as to the authority of the CEO to initiate discussions with another company's CEO about a proposed business combination. At what point is the CEO required to bring these discussions to the attention of the company's board of directors? What level of involvement is the board required to exercise in the process of negotiating the terms of a business acquisition in order to fulfill its fiduciary obligations to the company, as well as any other statutory requirements that may be imposed under the terms of modern corporation codes? The nature of these requirements under state and federal law will be introduced when we analyze the problems in Chapter 2.

As a preliminary matter, it is worth noting, however, that the relative balance of power between the board and the company's CEO is a topic of renewed interest in the wake of the crisis in investor confidence spawned by recent financial scandals involving Enron, Tyco, and others. In the wake of

these scandals, legislators, institutional investors, and other observers have been demanding greater oversight of management and greater accountability in the process of boardroom decision making. One of the most important decisions made in today's corporate boardrooms is the decision to pursue a business combination. The enhanced public scrutiny of boardroom decision making has led to renewed interest in the basic question of the board's involvement in the process of initiating and negotiating a business combination with another company. As we go through the problems in Chapter 2, we will examine this question of the board's involvement in the deal-making process in more detail along with the corporate governance implications triggered by this issue.

## 6. Shareholder Approval of an Acquisition

As we will learn when we analyze the problems in the next chapter, state law will often require shareholder approval of the terms of the proposed acquisition in order for the transaction to be validly completed. In those cases where shareholder approval is required, there will be the inevitable delay associated with noticing and conducting a meeting of the shareholders in compliance with the requirements imposed by the law of the state where the company is organized. Further delay may result if the company is publicly traded in order that the company may prepare and disseminate the disclosure required by the federal proxy rules whenever a publicly traded company solicits a vote by proxy from its shareholders. In Chapter 4, we will examine the nature of the disclosure required under the SEC's federal proxy rules, along with certain other provisions of the federal securities laws. At this juncture, however, the point to be emphasized is that compliance with these requirements imposed by state and federal law will definitely impact the time frame for completing a proposed acquisition.

## 7. Regulatory Approval of an Acquisition

Many acquisitions will require approval from federal and/or state regulators in order for the transaction to be validly consummated. This requirement may be imposed contractually (as a condition included in the terms of the parties' acquisition agreement) or alternatively may be imposed by statute. The approval most often required is clearance from antitrust regulators. This class will not dwell on the criteria used by the antitrust regulators to decide whether to approve — or clear — an acquisition, thereby allowing the business combination transaction to be completed. I assume that the criteria used by the regulators to decide whether a particular acquisition poses a threat to consumer welfare in violation of the terms of antitrust law is covered as part of a separate course on antitrust law offered in the curriculum of most law schools. Therefore, in Chapter 8, we will mention only a few details of antitrust law that directly and regularly affect mergers and acquisitions activity and of which M&A lawyers need to be aware, although usually antitrust counsel will be brought in to advise on any deals that will receive scrutiny from the antitrust regulators (a lesson learned well from the failed efforts of General Electric to

acquire Honeywell when the transaction failed to obtain antitrust clearance from overseas regulators).

In the case of companies operating within regulated industries — such as telecommunications, banking, or the airlines — separate approvals may be required from other government regulators (either at the state or federal level) in order to validly complete the transaction. As was the case with antitrust clearance, the requirement for these other regulatory approvals is often imposed contractually or may be required as a matter of law. In the case of these regulated industries, the reason the law intervenes to impose some form of regulatory review and approval is usually to protect some interest not adequately represented in the process of negotiating and completing a business acquisition, or to promote some other public policy goal that may be undermined by a proposed business combination. The public policy considerations that motivate policy makers at the federal or state level to intervene in the deal-making process through legislative action is not the focus of this class on M&A law. Furthermore, specialized bodies of law — such as labor law, environmental law, pension law, products liability law, telecommunications law, and intellectual property law — may be implicated in the context of a particular M&A deal. In those deals, the M&A lawyer may be required to seek specialized counsel to ensure compliance with the requirements imposed by the terms of these respective laws.

## 8. Closing on the Acquisition Transaction

After obtaining all necessary approvals, the parties' agreement will usually fix a date for closing on the acquisition. At this time, the Bidder will be obligated to pay the agreed upon consideration and the Target will be obligated to surrender control over its business operations. Until then Target continues to run the business, much in the same way that the seller continues in possession of the house until the close of escrow in a real estate transaction, at which time title and possession of the house are transferred from the seller to the buyer. As in the case of a real estate transaction, there is also the possibility that the deal may never close, even though the parties have a signed acquisition agreement in place. In many cases, the acquisition agreement will include certain conditions that must be satisfied in order for the deal to close. If these conditions are not satisfied, the acquisition will not close and Target will remain independent. The nature of these conditions to closing, and the consequences that flow from failure to satisfy such conditions, are explored in detail in Chapter 5, as part of our discussion of documenting the transaction.

## *E. Business Incentives for M&A Transactions*

The following excerpt provides further insight into the business incentives that generally motivate corporate managers to propose "business combinations," which the author (an economist, not an M&A lawyer) generally refers to as "mergers."

## 2. TAX AND ACCOUNTING ISSUES

Tax and accounting issues form perhaps the most important background for decisions about the form of acquisition to employ. Because a transaction can be taxable or non-taxable, the form may have a great deal to do with how much a buyer will have to pay to persuade owners of a target to part with their company. Because these issues are sufficiently complex, it is important for clients to understand these issues as they negotiate the price and structure of the acquisition. It is also important to recognize that the following description of these issues is much simplified, and is by no means a substitute for in depth knowledge of these issues.

### A. TAX ISSUES

While taxation of corporate acquisitions is often the subject of a separate law school course, it is important for those who do not take that course to have at least a basic understanding of the issues involved.<sup>1</sup> This section must begin with a distinction between acquisitions—a generic term—and reorganizations—which generally covers only those transactions where no taxable event is recognized.<sup>2</sup> It must also note the distinction between acquisitive “reorganizations,” the subject of this book, and bankruptcy “reorganizations.”

Shareholders of a target company would, in many cases, prefer a tax-free reorganization, because this allows them to defer recognition of taxable

1. Good brief reviews of this topic can be found in Howard E. Abrams and Richard L. Doernberg, *Federal Corporate Taxation* (2002), Chaps. 9–10 and in Barnet Phillips, IV and Robert P. Rothman, *Structuring Cor-*

*porate Acquisitions—Tax Aspects*, Tax Management Portfolio No. 770.

2. Tax-free reorganizations are covered in Internal Revenue Code of 1986, 26 U.S.C. § 368 (hereinafter “Code”).

gain until they dispose of the consideration (normally equity securities of the buyer) received in the reorganization. There may be cases where this is not a major consideration, and cash, which is fully taxable, would be more appealing. This may occur when the target corporation's shares have not appreciated significantly over a long period of time, so many shareholders will not recognize significant gains if they sell in a taxable transaction. It may also occur when the cash price is high enough to compensate most shareholders for the taxes they will incur.

Under modern accounting for acquisitions, buyers will have to record assets acquired either through a merger or asset purchase on their books at fair market value. In many cases this value may be well below the book value at which the assets were carried on the seller's books. Writing up assets to their fair market value increases the buyer's depreciation expense and lowers reported earnings. To the extent that the buyer can keep the asset valuation lower, it can record the balance of the purchase price as goodwill, which is not subject to depreciation or amortization. Sellers also prefer not to have much of the purchase price allocated to depreciable assets, because they may suffer depreciation recapture to the extent the purchase price exceeds the depreciated book value of the assets, which leads to payment of taxes on these gains at ordinary income rates. Sellers would prefer allocation to non-depreciable assets, such as land or goodwill, which permits capital gain treatment, taxable at a lower rate.<sup>3</sup> Because of the two levels of taxation that a seller will face in a taxable asset sale, at both the corporate level and then at the shareholder level if the selling firm is liquidated and the sale proceeds distributed to shareholders, this method is rarely employed.

The buyer's consideration of the preferable form of acquisition may be altered by the presence of tax loss carryforwards in the selling corporation. A corporation that has suffered a series of tax losses may carry those losses forward as a deduction against future taxable income. If the buying corporation acquires the shares of the target and keeps it as a separate entity, these tax loss carryforwards will remain available to offset future income of the acquired corporation, and of its parent if tax returns are filed on a consolidated basis.<sup>4</sup> A purchase of all the assets of the target in a taxable transaction does not transfer the tax loss carryforwards, while a purchase of assets in a tax-free reorganization does transfer them, as does any form of tax-free reorganization that meets certain requirements.<sup>5</sup>

The result of these incentives is that choice of form can have a significant influence on the ultimate price of the transaction. Selling shareholders will demand a higher price in a taxable transaction, and a

3. This subject is governed by Code § 1060 in the event the agreement does not allocate the purchase price.

4. 26 C.F.R. 1.1502-11 (hereinafter "Regs."). The availability of a share exchange under § 11.03 of the Model Business Corporation Act facilitates such transactions.

5. Code § 381(a)(2). There are, however, limitations on the use of net operating loss carryforwards by the acquiring or surviving corporation. Among other things, there must be satisfaction of continuity of business requirements. (Code § 382(c)) For other limitations, see Code § 383.

buyer seeking tax benefits from increased depreciation deductions may be willing to pay more in cash.<sup>6</sup>

### i. TAXABLE TRANSACTIONS

Asset purchases in a taxable transaction involve a bidder purchasing the assets of a target for cash and the subsequent liquidation of the target, which often distributes the cash to its shareholders. In this case the transaction would be subject to taxation at two levels. If the sale price of the assets exceeds their basis, the selling corporation has recognized taxable income to this extent, taxable at its current rate. When the selling corporation liquidates, the shareholders are again taxed on this distribution, to the extent it exceeds their basis in their shares.<sup>7</sup> This result can't be avoided by first liquidating through an in-kind distribution to shareholders, who then sell the assets to the purchasing corporation.<sup>8</sup>

Share purchases for cash involve only one level of taxation for the target corporation and its shareholders—the gain received by shareholders, measured by the excess of the purchase price over their individual bases in shares.<sup>9</sup> Similarly, a merger in which target shareholders received cash or debt is a taxable transaction, triggering capital gains treatment for target shareholders. At present there is a maximum tax of 15% on long-term capital gains, but there is no assurance this rate will remain in effect indefinitely.<sup>10</sup>

Acquiring corporations in taxable acquisitions recognize no taxable income in an acquisition of either assets or stock. They have a basis in either the assets or stock equal to the price paid.<sup>11</sup> However, if stock is purchased, the value of the assets is not stepped up to the amount of the purchase price, because the assets remain in the same corporation.

### ii. TAX-FREE REORGANIZATIONS

*General.* Shareholders who dispose of shares in a tax-free reorganization do not recognize gain or loss to the extent they receive “qualifying consideration.”<sup>12</sup> Similarly, the target corporation in a tax-free reorganization recognizes no gain or loss.<sup>13</sup> The buying corporation acquires shares in

6. This is borne out by some empirical studies, which show weighted average abnormal returns to target shareholders of 7.7% in mergers, while similar returns for shareholders in tender offers (which are always for cash), averaged 29.1%. The early evidence is summarized in Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 *J. Fin. Econ.* 5, 10-14 (1983).

7. Code §§ 331 and 1001.

8. On liquidation, the corporation would recognize a gain under Code § 336,

and the shareholders would be taxed on the difference between the fair market value of the assets and their basis in their stock under Code § 334(a). For an example, see Abrams & Doernberg, *supra* note 1 at § 9.01.

9. Code § 1001.

10. Code § 1(h).

11. Code § 1012.

12. Code § 354.

13. Code § 361(a) & (b).

a tax-free reorganization at the same basis as the selling shareholders.<sup>14</sup> It acquires assets from the target in a tax-free reorganization at the same basis as the selling corporation's basis.<sup>15</sup> There are three important types of tax-free reorganizations, discussed below.

**"A" Reorganizations.** The statutory merger or consolidation—the "A" reorganization—is the most flexible form of reorganization. Any form of consideration may be used—provided the continuity of interest doctrine—discussed below—is satisfied. The only disadvantage of this form is that the merger must be between the acquiring and acquired corporations.<sup>16</sup> This creates difficulties for many acquiring firms, because the triangular merger—between a subsidiary of the acquiring firm and the target—is often preferred, for reasons discussed in Part 3 of this chapter. In a triangular merger (the "(a)(2)(D) transaction"), the consideration paid is often shares of the parent corporation, but this triggers special rules not applicable when the merger is directly between the bidder and the target. In triangular mergers of this type, only stock of the parent, and not of the acquisition subsidiary, may be used to satisfy the continuity of interest requirement discussed below. Different rules apply to "reverse triangular" mergers, which are not discussed here. An "A" reorganization need not involve solely stock of the acquiring corporation as the consideration, although a significant amount—discussed below under the continuity of interest concept—must be stock. The balance is "boot." Shareholders in the selling corporation are subject to taxation on boot received, but only to the extent of their gains on the entire transaction.<sup>17</sup> Within the limits of the continuity of interest rules this permits bidders to offer target shareholders a choice between the bidder's stock and cash.

**"B" Reorganizations.** The exchange of voting stock of the target constituting control of 80% of the outstanding voting stock plus 80% of all nonvoting classes of stock solely for voting stock of the acquiring corporation or its parent is perhaps the least flexible form of reorganization.<sup>18</sup> Whether the acquisition is "solely" for voting stock of the buyer may turn on whether the buyer has previously purchased any of the target's shares for cash, and whether these purchases should be integrated with the exchange.<sup>19</sup> Receipt of any non-qualifying consideration ("boot") destroys the tax-free status of the reorganization.<sup>20</sup> Thus, the bidder's assumption of a target corporation liability guaranteed by a shareholder constitutes boot

14. Code § 362(b).

15. *Id.*

16. Code § 368(a)(1)(A).

17. Code § 356(a). While the general rule is that any gain recognized is taxable as capital gain, boot will be taxed as a dividend at ordinary income rates to the extent of retained earnings in the target corporation, if the exchange "has the effect of the distribution of a dividend."

18. Code § 368(a)(1)(B).

19. Most cases have held that earlier cash purchases absolutely violate the "solely for" requirement. See, e.g., *Howard v. Commissioner*, 238 F.2d 943 (7th Cir.1956); *Chapman v. Commissioner*, 618 F.2d 856 (1st Cir. 1980), cert. dismissed 451 U.S. 1012 (1981) and *Heverly v. Commissioner*, 621 F.2d 1227 (3d Cir.1980).

20. *Turnbow v. Commissioner*, 368 U.S. 337 (1961).

that violates the "solely" requirement.<sup>21</sup> Because so many transactions involving publicly traded companies involve the bidder's prior acquisition of some target stock for cash, the use of "B" reorganizations seems to be largely confined to the acquisition of closely held corporations. Until the 1980s, share exchanges were purely voluntary transactions, but the 1984 revision of the Model Business Corporation Act provides for share exchanges by corporate action.<sup>22</sup> Thus, if the required vote is obtained from the shareholders as a class, the exchange will be effected for all shares in the class. But this does not make it easier to use a share exchange for public corporations, because each shareholder has the right to dissent from the share exchange and be paid the fair value of his or her shares, thus destroying the "B" reorganization.<sup>23</sup>

**"C" Reorganizations.** The last major form of reorganization is the exchange of substantially all of a corporation's assets solely for voting stock of the acquirer.<sup>24</sup> But the interpretation of "solely for voting stock" of the buyer is much more flexible than in "B" reorganizations. Virtually all active businesses have some debt obligations; the inability of a buyer to assume these obligations in the course of a reorganization would render this form virtually useless. Accordingly, assumption of seller corporation debt is disregarded in a "C" reorganization. Further, up to 20% of the total consideration paid in a "C" reorganization may be in a form other than common stock of the buyer ("boot"). As previously discussed under "A" reorganizations, receipt of "boot" will be taxable to the shareholder. However, for purposes of determining how much "boot" has been paid, the value of seller corporation indebtedness assumed must be included in the calculation of "boot." Because there will be many cases where the debt assumed exceeds 20% of the total purchase price, the use of boot may be effectively precluded. The final requirement for a "C" reorganization is that the plan of reorganization must require the selling corporation to liquidate and distribute the stock and other consideration received, plus any remaining assets, to its shareholders.<sup>25</sup>

**Continuity of Interest.** In order for a transaction to qualify as a "reorganization," a substantial portion of the consideration paid must be in the form of stock of the acquiring corporation or its parent, with the rules spelled out with more specificity with respect to "B" and "C" reorganizations, as discussed above.<sup>26</sup> The stock may be either preferred or common, voting or non-voting, or participating or non-participating preferred.<sup>27</sup> In "A" reorganizations, there is no specific statutory requirement, and one case held that if 38% of the consideration were stock, that satisfied the

21. Rev. Rul. 79-4, 1979-1 C.B. 483.

22. Model Bus. Corp. Act ("MBCA")  
§ 11.02

23. MBCA § 13.02.

24. Code § 368(a)(1)(C).

25. Code § 268(a)(2)(G).

26. Regs. § 1.368-2(a).

27. See *John A. Nelson Co. v. Helvering*, 296 U.S. 374 (1935). "Participating" preferred stock is preferred which, after payment of its fixed dividend, shares in additional dividends on some basis with the common stock.

continuity of interest requirement.<sup>28</sup> In both “B” and “C” reorganizations, the Code provides that 100% of the consideration must be voting stock of the issuer, subject to the “boot” allowed in a “C” reorganization.<sup>29</sup> These rules represent a codification of previous judge-made rulings that for all acquisitive reorganizations, the shareholders of the target corporation retain a significant equity interest in the corporation following the transaction. The focus is on the stock received as a proportion of total consideration received—not on the proportion of the bidder’s stock held by target shareholders.<sup>30</sup> If the target shareholders intend to sell the bidder’s stock in the market immediately after closing, the continuity of interest requirement will not be met, because of the “step transaction” doctrine that folds together all planned steps into a single transaction.

**Business Purpose.** Regulations requiring the existence of a business purpose (other than tax avoidance) for the acquisition codify earlier judicial decisions in this area.<sup>31</sup> This requirement is normally not difficult to satisfy where the acquisition is on an arms’ length basis, and is most frequently problematic where the corporations are under common ownership or control.

**Continuity of Business Enterprise.** The regulations require that the acquiring corporation must either continue a line of the target’s historic business or use a significant part of the target’s assets in any business.<sup>32</sup> This is one way in which the Code prevents the acquisition of a corporation simply to take advantage of its net operating loss carryforwards, and “trafficking in net operating losses.”

28. Nelson v. Helvering, *supra*.

29. Code §§ 368(a)(1)(B) and 368(a)(1)(C).

30. See, e.g., Helvering v. Minnesota Tea Co., 296 U.S. 378 (1935).